BUSINESS STUDIES

A Textbook for Class XI

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राष्ट्रीय शैक्षिक अनुसंधान और प्रशिक्षण परिषद्
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Foreword

The National Policy on Education (NPE)1986 envisages reorientation of the content and processes of education in order to bring about qualitative improvement of education at the school stage. In this context, the Programme of Action (POA) evolved for implementation of the NPE, envisages development of instructional packages, including textbooks, based on the national curricular framework and their introduction into the school system in a phased manner.

In pursuance of the National Policy on Education — 1986, the National Council of Educational Research and Training (NCERT) has developed curriculum guidelines and syllabi for different curricular areas at different stages of school education. The Council for the first time undertook the task of developing curriculum guidelines and syllabi for Commerce at the higher secondary stage. An Advisory Board was set up under the Chairmanship of Prof P K. Ghosh, Professor of Commerce, Delhi University and Ex-Vice-Chancellor, North Bengal University, to develop curriculum guidelines and syllabi in Commerce and Accountancy and to provide guidance for development of instructional materials in these two subject areas.

On the advice of the Advisory Board, two teams were formed for developing the textbooks. Prof. P.K. Ghosh acted as the Chairman of the Subject Committee on Business Studies constituted by the Council for developing textbooks for Class XI. The Subject Committee on Business Studies included distinguished experts from the University Departments, professional institutions and the NCERT. The draft of the textbook was prepared by Prof. P.K. Ghosh, Prof. R A Sharma and Prof. R.G. Saxena. It was then thoroughly discussed in two workshops which were attended by practising teachers in schools, colleges and universities. In the light of the suggestions and reactions of the participants of the workshops, the manuscript was refined resulting in the book in its present form.

I am thankful to Prof. P.K Ghosh, Chairman of the Subject Committee on Business Studies who provided valuable guidance to his team of authors and finally edited the manuscript with Prof. R.G. Saxena My thanks are also due to all the members of the Subject Committee who attended review workshops and provided valuable suggestions and comments at different stages for the improvement of the draft manuscript.

The development of curriculum and textbooks calls for considerable expertise and efforts in planning the work, reviewing and editing of the manuscripts of the textbooks and finally in their publication.

I am grateful to my colleague, Prof. R.G. Saxena, Professor of Commerce, Department of Education in Social Sciences and Humanities (DESSH), NCERT who coordinated all the activities related to the development of curriculum and the textbook in Business Studies.

My thanks are also due to Prof. A.K. Jalaluddin, Joint Director, NCERT, who took keen interest in this project and extended all possible help in bringing out this book. I also express my thanks to Shri C N. Rao, Head, Publication Department, and his publication team for making all efforts in bringing out the book in time.

Curriculum designing and development of textbook is a challenging task It is an on-going process. There can always be some scope for further improvement in the curriculum and the instructional materials Therefore, suggestions from the users of this book for further improvement will be most welcome.

P.L. MALHOTRA
Director
National Council of Educational Research and Training

Preface

With the advancement of science and technology in the modern world business organisations have been subject to changes in different ways with respect to their number, size and complexity. The variety of goods and services which are produced and made available to people today are many times more than what it was earlier. The methods and techniques of production are undergoing continuous improvement. At the same time, the means of transport and communication are now characterised by quality of services unknown before. On the other hand, while the scope of business is expanding with ever-widening opportunities within and outside the country, market conditions are also subject to periodic changes in customer preferences, government controls and other factors Under these conditions, study of business in terms of its organisational diversities as well as different dimensions of trade and commerce has become increasingly more important Students interested in pursuing higher studies and those aspiring to engage themselves in business activities must be aware of the nature and types of business which dominate the economic system of every country. They must also be conversant with the environment of business firms which often determine their success or failure. It is in view of these needs that a new course on Business Studies was designed by the NCERT for the first time The syllabus is meant for students of senior secondary stage of education.

The book is based on the new syllabus developed by NCERT and which has been adopted by the CBSE, Delhi. The contents of the syllabus are divided into four-semester courses including two courses for class XI and two for class XII.

The book has been written by experts in the areas of business and management drawn from the academic, professional and teaching community. Each chapter is structured strictly according to the syllabus. The learning objectives are given at the beginning and is followed by an instruction to the topic. The text is arranged section-wise with proper sub-headings indicating sub-topics of the main chapter. There is a summary of contents at the end of each chapter and questions relating to the main topic sub-divided into three categories, viz. objective type, short-answer type and essay type questions.

Effort has been made to make the text easily understandable by the readers as well as to help them prepare for their examinations. Technical terms used have been explained in simple words without sacrificing their interpretation in the business world.

We are thankful to Prof. Brij Mohan, Dr. A N. Gupta, Shri T N. Chhabra, Shri J.S. Mahajan, Dr. S.K. Gupta, Ms. Minoo Nandrajog and Miss Renu Kulshreshtra who assisted in the preparation of the draft manuscript of this book and joining the discussion at the various stages of review of the manuscript.

We have spared no efforts to make the book useful to the students community and teachers whose response is of great value to us.

We look forward to the suggestions of students and teachers for improving the text.

AUTHORS

GANDHIJI'S TALISMAN

"I will give you a talisman. Whenever you are in doubt or when the self becomes too much with you, apply the following test :

Recall the face of the poorest and the weakest man whom you may have seen and ask yourself if the step you contemplate is going to be of any use to him. Will he gain anything by it ? Will it restore him to a control over his own life and destiny ? In other words, will it lead to Swaraj for the hungry and spiritually starving millions ?

Then you will find your doubts and your self melting away."

mkGandhi

Contents

CHAPTER 1

Economic Activities and Business

LEARNING OBJECTIVES

After reading this chapter you will be able to:

1. explain the meaning of economic activity and distinguish between economic and non-economic activities;
2. enumerate the types of economic activities,
3. describe the meaning and definition of business,
4. identify business as an economic activity;
5. outline the range and examples of business activities;
6. differentiate between business and other economic activities.

1.1 INTRODUCTION

All of us live in families, and depending on the income we have different standards of living. We require various types of goods and services to satisfy our needs. Some member in every family has to work to earn and provide for the needs of all other members. Thus, people engage in different activities for earning their livelihood. In earlier days, people had limited wants to satisfy. But in modern times we need a large variety of goods and services for various purposes which are available in the market. There is increasing demand for goods and services due to our desire to raise the standard of living. On the one hand, activities of different types are undertaken by people who earn sufficiently to fulfill their increasing needs. On the other hand, the supply of goods and services has also led to various activities of people so as to produce and sell what are needed by others. Thus, we find a large number of people working in mines, factories and offices to earn their livelihood. At the same time, there are other people who undertake production and supply of goods and services. For example, farmers produce agricultural crops which they sell in the market. Goods are produced in factories and sold in retail shops. Trucks are used to carry goods from one place to another. Water and electric supply is arranged for use in factories as well as for domestic consumption. The purpose behind most of these activities of human beings is earning money to satisfy the increasing demand for goods and services.

1.2 MEANING OF ECONOMIC ACTIVITIES

Activities which are undertaken by people to satisfy their wants directly or indirectly are known as *economic activities*. These activities may be undertaken to produce something for own consumption or to earn income to buy goods from the market. They may be pursued by individuals or groups either on a large scale or on a small scale. A blacksmith, a cobbler, or an icecream vendor may be said to engage in economic activities individually and on a small scale. On the other hand, factories which are set up to produce goods or agricultural crops produced in big farms for sale may be regarded as large scale economic activities. In such activities groups of people are engaged in various kinds of work.

1.2.1 Distinction Between Economic and Non-economic Activities

We have already discussed that all activities which are undertaken by people to earn income and to meet their needs are economic activities. These activities may also be undertaken for creation of wealth, that is, acquisition of properties and assets. But there are various other activities which people undertake without any such purpose. For instance, housewives are engaged in various activities to run the household. People often undertake social activities to assist poor families or handicapped persons. Ladies who have spare time help others to learn different crafts like sewing, stitching, etc. The purpose behind these activities is not to earn money but to derive personal satisfaction. Therefore, these activities are called *non-economic activities*.

Thus, a farmer producing wheat for his own consumption, or for sale, will be regarded as engaged in economic activities. But people who are engaged in private or social activities like performing household work or helping the poor, will be regarded as undertaking non-economic activities.

DIFFERENCE BETWEEN ECONOMIC AND NON-ECONOMIC ACTIVITIES

	Economic Activities		*Non-economic Activities*
1	Based on economic motives	1	Based on social or psychological motives
2	Money income is expected	2	Money income is not expected
3	Undertaken for creation of wealth or assets	3	Undertaken for psychological satisfaction

1.3 TYPES OF ECONOMIC ACTIVITIES

When a person is regularly engaged in a particular activity it is known as *his* or *her* occupation Economic activities may thus be called occupations of people Broadly speaking, the occupation of people or economic activities can be divided into three categories:

1. Profession
2. Employment
3. Business

1.3.1 Profession

Activities which require special knowledge and skill to be applied by individuals in their work to earn a living are known as *professions*. Doctors are engaged in the medical profession, teachers are in the teaching profession, lawyers in the legal profession, engineers in the engineering profession, accountants in the accounting profession, and so on They are called professionals Sportsmen may also be called professional sportsmen if they earn their living on the basis of their training and skill in particular games or sports.

1.3.2 Employment

When people work regularly for others and get remuneration in return they are said to be in *employment* People who work in factories and receive wages and salaries are in the employment of factory owners. They are called *employees* Similarly, men and women work in the offices of banks, insurance companies, or government departments, in different capacities They are said to be in employment earning salaries as managers, assistants, typists, clerks, peons, sweepers, guards, etc.

1.3.3 Business

Activities connected with the production or purchase and sale of goods or services with the object of earning profit are called business activities. These include mining, manufacturing, trading, transporting, banking, insurance, etc Persons engaged in these activities earn income in the form of profits.

TYPES OF ECONOMIC ACTIVITIES

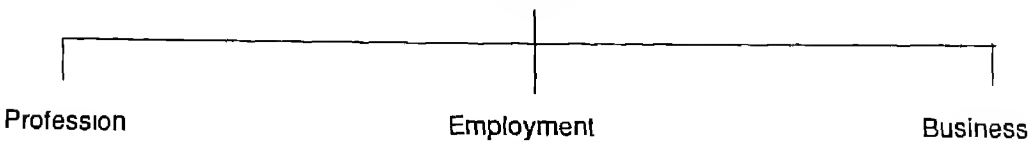

Fig. 1.1

1.4 MEANING AND DEFINITION OF BUSINESS

Business literally means *to be busy*. However, the meaning of business more specifically is that of being busy to earn income Thus, business includes all occupations in which people are busy earning income either by production or purchase and sale or exchange of goods and services to satisfy the needs of other people Since the main objective of business is to earn an income or profit through business transactions it is an economic activity Thus, *business may be defined as an economic activity which involves production or purchase and sale, transfer or exchange of goods and services at a profit*. It relates to the creation of form utility through processing, time utility through storage and place utility through transportation The purpose is to supply goods and services to those who are prepared to pay the price. A business activity may be carried on either on a large scale or on a small scale Thus, a vendor, a small shop-keeper, or an owner of a big factory are considered to be engaged in business

1.5 BUSINESS AS AN ECONOMIC ACTIVITY

As discussed earlier business activities consist or producing or purchasing and sale or exchange of goods and services to earn an income in the form of profit.

Business is regarded as an economic activity for the following reasons.

(i) The purpose behind every business activity is to sell goods or services for profit. If a family grows vegetables in the garden for consumption by members of the family, it is an economic activity, but not a business activity. However, if the vegetables are sold in the market it will be a business activity This is because the purpose then is to earn an income in excess of the costs incurred for growing the vegetables

This excess is called *profit* Manufacturers produce goods not for their own use, but for sale. Traders buy goods, not for their own use but for sale The income earned by a businessman in the form of profit enable them to satisfy their requirement of food, clothing, shelter, education of children, etc

(ii) Business activities require use of scarce resources like men, materials and capital To run a factory the owner must have adequate capital, procure raw materials, and employ skilled workers He may not have his own savings to invest He must, therefore, raise funds from other sources. Similarly, he has to arrange raw materials from suppliers. Further he must engage suitable men for production purposes. For all these resources he must bear the initial expenses before the goods are produced and exchanged for money so as to recover the expenses and earn profit Thus, business always involves use of scarce resources as well as exchange of goods or services for profit

(iii) Business activities satisfy various needs of businessmen and the general public Business is a source of income for businessmen and their families. Business activities also serve the general public by making available goods and services which they can buy to satisfy their needs Business can therefore be regarded as an economic activity not only as a means of earning income by businessmen but also as a means of satisfying the wants of people in general

1.6 RANGE AND EXAMPLES OF BUSINESS ACTIVITIES

There are different types of business activities which may be classified as:

1. Industry 2. Commerce

1.6.1 Industry

Industry includes activities connected with raising, producing or processing goods. For example, agricultural crops like cotton, jute, oilseeds are raised by farmers for sale in 'Mandis' or markets Goods like cloth, paper, sugar, etc. are produced in factories for consumption by people Similarly, tools, equipments and machines are manufactured which are meant for use in other factories. Oilseeds are processed to extract oil for cooking and other uses

Industrial activities can be undertaken on a small scale or on a large scale. For instance, cloth or textile products can be produced in large textile mills as well as on a small scale in handlooms or powerlooms Extraction of edible oil from oilseed takes place in 'Kolhu' or 'Ghani' on a small scale as well as in oil mills on a large scale Similarly, leather goods (shoes, ladies bags, etc.) are produced in small quantities by producers using simple tools, while there are large factories as well which produce shoes of standard sizes on a mass scale. Animal husbandry and poultry farming, forestry and fishing, garment-making, rice-milling, bidi making, production of match boxes, candle-making, etc. are mostly carried on in small establishments Mining and extraction of fuel oil take place generally on a large scale. Manufacture of consumer goods for mass consumption and of machines and tools also take place on a large scale.

1.6.2 Commerce

Commerce is another branch of business involving activities related with sale, exchange, or transfer of goods and services Thus, commercial activities include trade (buying and selling of goods), transportation (movement of goods), banking (financing of trade), storage or warehousing of goods, and insurance (covering the risks of fire, theft, etc)

Commercial activities, like industries, can also be undertaken on a small scale as well as on a large scale. Thus, retail traders buy and sell goods in small quantities, while wholesale traders buy goods in large quantities and sell smaller quantities to the retailers. Storage can be arranged on a small scale in godowns, although there are warehouses also for storage of goods in large quantities Transportation on small scale is undertaken by truck operators. On the other hand, large quantities can be transported by railway wagons or ships Banking and insurance business, however, require large-scale operation to be profitable

Trading activities as mentioned earlier, provide the link between producers and consumers of goods. Trade is an important branch of business It is because of trading activities that goods can be produced on a large scale in anticipation of demand Trade may include buying and selling of all types of goods and services, for example, agricultural crops (like wheat, cotton and jute), consumer goods like (paper, sugar and soap) and capital goods (like machines and equipments) Goods produced within a country and also produced in other countries are available to consumers through trade. With the passage of time the volume of trade has increased. This has been due to production on a large scale, wider range of goods produced and the widening of markets from local areas to foreign countries. Along with the growth in the volume of trade, the scope of other business activities has also expanded a great deal

1.7 DIFFERENCE BETWEEN BUSINESS AND OTHER ECONOMIC ACTIVITIES

We have already mentioned that economic activities include business, profession and employment Let us now examine how business differs from profession and employment

(i) Mode of Establishment. A business enterprise may be established anytime. Some legal

formalities may have to be completed where necessary. For example, to start a restaurant a licence from the Health Department has to be obtained. Similarly, to set up a factory registration under the Factories Act is required A professional firm may be started by anyone who is either a member of, or registered with a professional body and holds a certificate of practice. For instance, a doctor, who is registered with the Medical Council, may start a clinic. A lawyer may start legal practice by enrolling himself as a member of the Bar Council. Similarly, a firm of chartered accountants may be established by those who are members of the Institute of Chartered Accountants, and hold certificates of practice. In the case of employment, a person has got to be selected by the employer and has to enter into an agreement of service. Thus, it involves employment with someone else, while business and profession relate to self-employment.

(ii) Nature of Work: A business unit is engaged in the production and purchase of goods and services for the purpose of sale, transfer or exchange in order to satisfy customers' needs. On the other hand, the practice of a profession relates to rendering personal services of a specialised nature to the clients. In the case of employment, an employee has to perform the work assigned to him by the employer under the agreement of service.

(iii) Qualifications. For establishing a business enterprise, a person need not possess any formal degree or prescribed qualifications. But in the case of profession specified qualifications are essential. In employment, education and training are not always essential. However, qualified and trained persons generally get better employment.

(iv) Investment of Capital No business enterprise can be established without some amount of capital or investment. The amount of capital depends on the size and scale of operations. A professional has also to invest a limited amount of capital to establish his clinic or office, while in the case of employment there is no need for capital investment

(v) Basic Motive Business activities are guided primarily by the motive of earning profit But professional activities are generally expected to be governed by a service motive besides that of earning income In the case of employment, the employee performs duties assigned to him by his employer for which he receives remuneration under the agreement of service.

(vi) Return or Reward A businessman earns profit from his business, while a professional earns fee for his services, and an employee earns salary or wages for his work.

(vii) Element of Risk There is an inherent element of risk in case of both business and profession A business may run into losses and a professional may be unable to earn any income. However, the fee of a professional can never be negative. In case of employment, there is no risk so long as the employer continues his operations The employee generally gets a fixed and regular salary.

(viii) Transfer of Interest: A businessman can transfer ownership interest in the business enterprise any time at his will Sometimes he may have to follow the prescribed formalities For example, a trader may sell his shop to someone else if he so desires A factory may be transferred or sold by its owner But in the case of profession or employment such a transfer is not possible at all. A doctor or a lawyer cannot sell or transfer his certificate of practice to any one else Similarly, an employee cannot ask any other person to work in his place without the consent and approval of the employer.

(ix) Code of Conduct: There is no prescribed code of conduct or ethics provided for a businessman A professional is required to follow the code of conduct specifically prescribed by the professional body for the profession The conduct of an employee is regulated by the rules prescribed by his employer

BUSINESS, PROFESSION AND EMPLOYMENT DISTINGUISHED

Basis	Business	Profession	Employment
1 Commencement or establishment	Entrepreneur's decision and legal formalities (if necessary)	Membership of a professional body or certificate of practice	Letter of appointment and service agreement
2 Nature of work	Production or purchase and sale or exchange of goods and services	Personalised service of expert nature	Performing the job assigned by the employer
3 Qualifications	No formal qualifications are required	Prescribed qualification and training are essential	Qualification and training not necessary in all cases
4. Capital or Investment	Capital is needed according to the size of the firm	Limited capital is required for establishment	Capital is not required at all
5 Basic Motive	Earning Profit	Rendering service besides earning income	Earning salaries or wages
6 Return or Reward	Profits	Professional fee	Salary or wages
7 Element of risk	Present	Present	Absent
8 Transfer of Interest	Possible	Not possible	Not possible
9 Code of Conduct	No prescribed code of conduct to be followed	Professional code of conduct to be followed	Rules laid down by the employer to be followed

SUMMARY

1. Economic and Non-economic Activities

Activities which are undertaken by people to satisfy their wants directly or indirectly are known as *economic activities* These activities may be undertaken to produce something for *own consumption* or to *earn income* for purchase of goods *Non-economic activities* are private or social activities which people undertake to derive personal satisfaction

2. Types of Economic Activities

Economic activities may be divided into three categories (i) Profession; (ii) employment; and (iii) business. Activities which require special knowledge and skills to be applied by individuals in their work to earn a living are known as *profession* When people work regularly for others and get remuneration in return, they are said to be in *employment* Activities connected with the production or pruchase and sale of goods and services with the object of earning are called *business activities*

3. Definition of Business

Business includes all occupation in which people are busy earning income either by production or purchase and sale or exchange of goods and services to satisfy the needs of other people so as *to earn a profit*

4. Business as an Economic Activity

Business is regarded as an economic activity because
(i) the purpose behind every business activity is to sell goods and services for profit, (ii) business activities require use of scarce resources, and (iii) these activities satisfy various needs of businessmen and the general public

5. Range of Business Activities

Business activities may be classified as (i) industry, and (ii) commerce Industry includes activities connected with raising, producing or processing goods. Commerce is related with activities involving sale, exchange, and transfer of goods and services *Commercial activities* include trade, transportation, banking, warehousing and insurance Both industrial and commercial activities can be undertaken on a small scale and a large scale Trade may include buying and selling of goods and services within the country or outside.

6. Difference between Business and Other Economic Activities

Business differs from profession and employment with regard to mode of establishment, nature of work involved, qualifications required, investment of capital, basic motive, return or reward, element of risk, transfer of interest and code of conduct

QUESTIONS

I OBJECTIVE TYPE

Which of the following statements are right and which are wrong?

1 A person without special knowledge and skill cannot undertake any business activity
2 Donation made by a teacher to the sports fund of the school is an economic activity
3 Non-economic activities are those from which people get psychological satisfaction
4 Both industrial and commercial activities are business activities
5 Business activity necessarily means sale or exchange of goods or services
6. A farmer growing wheat for the consumption of his family is engaged in business activity.
7 A house-wife cooking food for her family members is engaged in economic activity

II SHORT ANSWER TYPE

1 Define business
2 What is an economic activity?
3. Distinguish between economic and non-economic activities
4 What is the difference between business and profession?

III ESSAY TYPE

1. Explain why business is regarded as an economic activity
2 Distinguish between small scale and large scale business activities Give examples
3 Define business and distinguish it from profession and employment

CHAPTER 2

Nature and Purpose of Business

LEARNING OBJECTIVES

After reading this chapter you should be able to:

1. enumerate the economic and social objectives of business;
2. explain the characteristics of business;
3. describe the nature and causes of business risks;
4. analyse the role of profit in business;
5. state the case for social obligations of business;
6. outline the responsibilities of business towards different interest groups; and
7. explain the concepts of social values and business ethics.

2.1 INTRODUCTION

We have discussed in the previous chapter that business as an economic activity consists of production, purchase and exchange of goods and services The basic objective of every business activity is to earn profits. In other words, the results of business operations are expected to lead to profits In order to earn profits businessmen must satisfy their customers This is because it is only when customers are satisfied with the quality and price of goods that they will continue to buy them This, in turn, requires that goods must be produced efficiently and economically. For that purpose capable and efficient persons must be employed. They should be paid attractive remuneration and provided with proper working conditions Again, to be able to compete with other producers a businessman should try to develop new products. For existing products, new ways and means should be developed to make them more useful to the consumers at reasonable rates Unless these requirements are fulfilled a business cannot survive for long.

But businessmen sometimes try to make profits without regard to the means adopted for that purpose. A business may earn large profits by selling goods at a high price. This is generally done by making false claims about the superiority of the product over other similar products In the short run, it may be possible because of consumers' ignorance. But in the long run this way of running business may not succeed. Sooner or later consumers will become conscious that they are being over charged and that the goods are inferior in quality Under these circumstances, the business is bound to suffer as a result of consumers' loss of faith. Thus, to run a business successfully, is not enough to pursue the objective of earning rofit only Instead, several other objectives must e kept in view so that profits may continue to be arned regularly and business may grow in course f time.

2.2 ECONOMIC AND SOCIAL OBJECTIVES OF BUSINESS

Business objectives may be broadly classified into *economic objectives* and *social objectives*

2.2.1 Economic Objectives

The main economic objectives which every business must pursue are the following

(i) Earning profit To earn profit is the primary economic objective which must govern all business operations This is because every business activity is undertaken primarily to earn profit—the excess of income over expenses One cannot expect to be in business without making profits If he continues to incur losses his business will fail Further, profits not only help businessmen to earn their living, but also help them to expand their business activities. The growth of every business depends largely on its ability to earn profits Out of these profits some amount may be utilised by the businessman for own use, while the balance may be reinvested for increasing the size of business

(ii) Creation of customers. Another economic objective which needs to be pursued by business firms is the creation of customers Business activities can be sustained only if there is a demand for goods or services offered for sale. Sometimes new products are offered by businessmen for which demand may be created It is generally done through advertisement and promotion of sales in different ways, like distribution of sample, etc. Thus, it is the number of customers that determines the profitability of business. It is, therefore, necessary for every business to ascertain what kind of products people want, where they want the products, and when.

(iii) Innovation. To innovate means to explore and discover ways and means of making products more useful It also includes improved methods of production, exploration of new

markets, and use of better methods of distribution. Making colour television in place of black and white sets is an example of *product innovation* Using powerlooms instead of handlooms for weaving is an example of *process innovation.* Selling of goods through retail shops of the manufacturer instead of through dealers or wholesalers may be regarded as an example of innovation of *distribution methods*

In a competitive market, every business must be on the look out for introducing new products or making existing products more useful It may be possible by adopting new methods or processes of production. Businessmen must also arrange for sale of goods by improved methods so as to reach customers in new markets In the absence of these efforts it may not be possible for the firm to continue its business Thus, an important economic objective to be pursued by business is innovation.

(iv) Best possible use of scarce resources Business activities require the use of men, machines and materials which are considered to be scarce resources Every business is expected to have the objective of making the best use of these resources. This objective can be achieved by employing efficient personnel, making full use of machines and reducing wastage of raw materials Further, ways and means should also be found to make use of the waste materials Methods of waste treatment have been developed and adopted by various industrial units to make the waste materials commercially useful.

2.2.2 Social Objectives

Business is an integral part of society. No business activity can be undertaken in isolation from the rest of the society. Business must, therefore, fulfill the expectations of society Business activities must be conducted according to what people consider desirable. Undesirable activities should not be undertaken, nor should undesirable practices be adopted for the sake of profits. Manufacture or sale of adulterated goods is always against the interest of society No business can be successful in the long run if such practices are adopted. Thus, in the long run interest of business itself social objectives should form a part of business objectives. It is interesting to note that government enterprises give special attention to social objectives Four most important social objectives are:

(i) Supply of desired quality of products,
(ii) Avoidance of anti-social and unfair trade practices,
(iii) Generation of employment; and
(iv) Welfare of employees

Let us now discuss each one of these social objectives in detail.

(i) Supply of desired quality of products In every society it is expected that business firms will supply goods of the right quality at the right price. Quality may mean *durability*, as in the case of camera, radio, etc. or *purity* as in the case of medicines, or *safety* as in the case of pressure cooker, scientific instruments, etc. Consumers will not prefer to buy a product if it is not satisfactory from the point of view of quality, and is not available at a reasonable price Hence, an important social objective of business should be to produce and sell goods of proper quality at reasonable price.

(ii) Avoidance of anti-social and unfair trade practices Anti-social practices like hoarding, black-marketing and over-charging buyers are regarded in every society as highly undesirable activities. Some businessmen advertise so as to give a false impression about the quality of their products This practice is adopted to mislead people and make money by exploiting them. A business which is known to adopt anti-social or unfair trade practices not only earns a bad name but is also liable to punishment. It may be in the form of fine and even imprisonment Thus, an important social objective of business should be to avoid such means of earning profits

(iii) Generation of employment Business firms employ people for different types of work This leads to generation of employment and income in society Besides, people who are handicapped or poor are also given special consideration at the time of recruitment To make them useful in work, training is imparted where necessary. This practice helps in increasing the earnings of poor families, and makes handicapped people useful to the society Business firms which pursue these objectives improve their public image.

(iv) Welfare of employees Another important social objective of business is to look after the welfare of employees who contribute to the success of business. Thus, business firms provide for good working conditions for employees and pay them satisfactory wages and salaries Decisions affecting the employees are also taken by managers in consultation with the representatives of employees. Large business firms generally provide for housing and medical facilities for the employees and their family members. This is because welfare amenities are expected to improve the efficiency of employees and thereby raise the profitability of business

2.3 CHARACTERISTICS OF BUSINESS

We have discussed in the previous paragraphs the various economic and social objectives which should be pursued in the long run interest of business firms. Let us now consider the main characteristics of business activities The characteristics may be listed as follows:

(i) Sale or exchange of goods and services for the satisfaction of human needs. All business activities directly or indirectly involve transfer or exchange of goods and services for value. If goods or services are consumed by the producer or buyer, it cannot be called a business activity Or, if goods are purchased by one to be presented as a gift to someone else, it is not business. Cooking food at home for the family is not business but, cooking food and selling it to others in a restaurant is business. Thus, one essential characteristic of business is that there should be sale or exchange of goods and services

(ii) Dealing in goods and services Dealing in goods and services is another distinct feature of business Goods produced or purchased for business purposes may consist of consumer goods like foodstuffs, cloth, etc , or capital goods like machinery, tools and equipments *Consumer goods* are generally meant for direct consumption, while *capital goods* are used for producing other goods. Services are facilities offered to consumers in the form of transportation, banking, insurance, supply of water, electricity, etc

(iii) Regularity or continuity of dealings Business activities consist of regular or continuous transactions involving sale or exchange of goods and services Business activity should be carried out frequently. One single transaction does not constitute business. Thus, if a person sells his domestic radio set even at a profit, it will not be called a business activity. But if he sells radio sets frequently either through a shop or from his house it will be a business activity

(iv) Profit earning Every business activity is carried on with the purpose of earning an income in the form of profit. No business can survive for long without earning profits That is why businessmen make all possible efforts to earn satisfactory profits by increasing the volume of business or by reducing costs.

(v) Uncertainty of return Every business requires some amount of money to be invested to run the activities. Profits are expected to be earned in proportion to the amount invested in the business. But it is not certain that adequate profit will be earned. There is always a possibility that losses may be incurred inspite of best efforts This is because business conditions may change leading to a decline in production or sales. Also there may be unexpected situations beyond the control of businessmen as a result of which losses may be

incurred These possibilities are known as *risks of business* There are several factors related with business risks, such as (a) change in consumer tastes and fashions, (b) changes in the methods of production, (c) strikes and lockouts in work places, (d) increase of competition in the market, (e) fire, theft, natural calamities and accidents No business can altogether do away with risks Hence, uncertainty of return may be regarded as a significant characteristic of business

2.4 NATURE AND CAUSES OF BUSINESS RISKS

The success of a business firm does not depend only on the efforts of those who run the business. It depends on the existence of favourable conditions. If the business conditions are not really favourable the possibility of a set-back cannot be ignored Business risks refer to the possibility of inadequate profits or even losses due to uncertainties or unexpected events which are beyond control. For instance, the demand for particular products may decline due to a change in the taste and fashion of consumers, or due to increased competition. These are not easily predictable, nor fully controllable, by a business firm. Goods are generally produced and held in stock in anticipation of sufficient demand Hence profits are likely to decline if there is a fall of demand. Losses may also be caused by unforeseen events. For example, import of certain raw materials may be restricted by government. This may lead to a rise in the price of raw materials, increase the cost of production, and, in turn, reduce profits. In fact, there are a number of causes which make business activities risky. The more important causes of business risks are the following:

(i) Uncertainties relating to demand for goods, prices, competition, exchange rates affecting the cost of imports and exports, change in technology, government control, and realisation of customers dues.

(ii) Unforeseen losses due to theft, fire and other calamities like flood, earthquake, etc

(iii) Unexpected events like stoppage of work due to power failure or strike, damage of goods in transit, death or departure of a key employee, etc

(iv) Factors affecting the availability of funds like changes in interest rates, taxes, etc

Business risks arising out of one or more causes are to a large extent unavoidable. But some of the risks can be covered by insurance. The losses suffered can be recovered if the risks are insured on payment of a nominal amount of premium for insurance. Thus, the risks of loss by fire or theft, and the risk of loss or damage of goods-in-transit can be insured Certain risks can be shared also Thus, manufacturers and wholesalers may come to an agreement to share any loss which may be caused by falling prices

2.5 ROLE OF PROFIT IN BUSINESS

We have already discussed that earning profit cannot be the only objective of business. Indeed, for a business to be able to earn profits and grow, it has to pursue certain other economic and social objectives However, the importance of earning profit cannot be ignored It may be regarded as an important objective of business which will be clear if we analyse its role from different points of view

First and foremost, it is a source of income and provides the *means of livelihood* for the businessmen No one is expected to undertake business activities without earning an income to satisfy his needs.

Secondly, a part of the profits can be used for increasing the *volume of business*, i.e for business growth. When profits are large, it is always desirable to reinvest a reasonable portion of it to increase or diversify production, or to create new

facilities for more efficient operation. Retention of profit as an internal source of funds is a more dependable source of financing than external sources like banks and financial institutions, or individual investors

Thirdly, profits indicate whether a business is being managed efficiently or not. Hence, profit is regarded as *an index* of performance of those who manage the business. The success of a business can be judged by reference to its ability to earn profits.

Fourthly, profits also represent *a reward for risk bearing*. A businessman invests money to undertake business activity but the risk and uncertainties of business conditions involve the possibility of incurring losses as well Even then he runs the business in the hope of earning sufficient profits by overcoming the risks It is because of profits that taking risk becomes worthwhile in business

Last but not the least, with increasing profits over time, a business firm gains *reputation*. It is able to raise loans and obtain credit more easily. It is in a better position to offer wages and salaries for the purpose of attracting trained and experienced employees Further, the existing employees can be provided with better working conditions and more amenities if the business is profitable.

2.6 CASE FOR SOCIAL OBLIGATION OF BUSINESS

Social obligation means the obligation or responsibility of business to act in a manner which will serve the best interest of the society. It may be noted here that social obligation of a business is different from legal obligation. Legal obligation may be fulfilled by mere compliance with the law but social obligation is not covered by law. It relates to the voluntary efforts on the part of businessmen to adopt ways and means to solve social problems. It is based on the assumption that what is good for society is also good for business.

It is sometimes believed that if a business firm continues to make profit, resources drawn from society are being used in the best possible way. Further, it is argued that businessmen are not competent to decide what is to be done in the best interests of society. If they try to engage in social activities, their performance will be poor. They are best able to manage business affairs, and should engage in business activities only. These arguments may be valid in a limited sense but are not in accordance with present day thinking. Besides, increasing public consciousness of their own rights has also contributed to the recognition of social responsibilities by business firms. The case for social obligation of business is as follows:

(i) Long-term interest of business: Every business is a part of society. Therefore, businessmen must consider it to be their duty to satisfy the needs of society before using profits only for their own benefit Social improvements may be brought about by developing educational opportunities, pollution control, or upliftment of the poor. If a part of the business income is spent for improving the social conditions, it is bound to create an environment most favourable for the long run prosperity of the business.

(ii) Public image. The profits of a business firm depend, to an extent, on its public image A business firm can build up its public image if it undertakes activities for social good. Such a business generally enjoys the support of its customers. Thereby it is also able to increase its earnings.

(iii) Avoidance of government regulation: If businessmen voluntarily discharge social obligation, need for government regulation is avoided For instance, if there is pollution of air or water due to manufacturing activities, it is desirable that

the owner of business should voluntarily take steps to prevent it. If that is not done, government may not allow the business to continue in that area Hence, the business may have to be closed or shifted to some other place involving huge expenditure. Such a situation could be avoided if pollution control was undertaken by the business itself.

(iv) Moral justification: Every business enterprise is a part of society and depends on the society in a number of ways It makes use of physical and human resources and funds available for business purposes. It also depends on society for the disposal of goods and services which are offered for sale Further, business firms make use of various common facilities provided by society like roads, power and water supply Therefore, it is the moral responsibility of business to contribute to the well-being of society.

(v) Consumers' consciousness In recent years many consumer groups have been organised to educate the public about their rights as consumers. Complaints of consumers about defective goods or overcharging are taken up by such organisations. They compel the producers and dealers to either replace the goods or refund the excess price paid This development makes it necessary for businessmen to serve the interest of consumers by supplying the desired quality of goods at a reasonable price.

2.7 RESPONSIBILITY TOWARDS DIFFERENT INTEREST GROUPS

The social responsibility of business is generally defined by reference to its responsibilities towards the following interest groups in society.

(i) Owners;
(ii) Employees,
(iii) Consumers,
(iv) Suppliers;
(v) Government, and
(vi) Community and Society

(i) Responsibility towards owners It is the primary responsibility of the mangers of business that owners should be assured of a fair and reasonable rate of return on their capital The expected rate of return depends on the nature of business, risks involved and the return earned by similar other firms In the case of companies, shareholders (owners) expect that the value of their share should not fall but it should increase They also expect regular and accurate information about the working of the company.

(ii) Responsibility towards employees Another responsibility of business consists of paying fair wages to employees and providing security of job and promotional opportunities Apart from these, welfare amenities like satisfactory working conditions, medical facilities, housing, canteen, leave and retirement benefits should also be provided to the employees to make them more efficient and loyal. These facilities are also considered necessary due to pressure groups like trade unions and increasing consciousness of workers

(iii) Responsibility towards consumers. This should be regarded as the most important responsibility of business. If the customers are not satisfied as regards the quality and price of goods, business cannot survive For the satisfaction of customers the business should also avoid unfair trade practices This is all the more important because of increasing consciousness among consumers about their rights.

(iv) Responsibility towards suppliers: Every business enterprise should develop and maintain healthy relations with the suppliers. In order to get regular and timely supply of raw materials and other items, dealings with the suppliers should be based on fair terms and conditions regarding price, regularity of payment, etc.

(v) Responsibility towards government It is expected that business will be conducted in lawful manner and businessmen will comply with all legal requirements. Further, it is expected that taxes would be paid honestly and in time. Sometimes businessmen do not disclose all their incomes and record the expenses which they have not actually incurred This practice leads to tax evasion Such practices are illegal and should be avoided in their own interest because if they are detected then heavy penalties are to be paid.

(vi) Responsibility towards the community and society. Business responsibility towards the community requires that firms should contribute to the safety and welfare of the community at large. Production of goods on a large scale often leads to the pollution of atmosphere, air and water. Business firms should take necessary steps to prevent it. Leakage of poisonous gas from Union Carbide factory at Bhopal in December, 1984 caused unprecedented human disaster Such instances are really unfortunate It is the responsibility of businessmen to provide for adequate safety precautions to avoid such tragedies. Contribution to the welfare of society is equally important Some large business firms have started responding to this obligation by initiating programmes of rural and community development.

2.8 SOCIAL VALUES AND BUSINESS ETHICS

Social values refer to the basis on which members of a society judge each other's conduct or behaviour Values determine what people consider to be good or bad for society, or what is right or wrong. In relation to business activities, social values

RESPONSIBILITY OF BUSINESS TOWARDS DIFFERENT INTEREST GROUPS

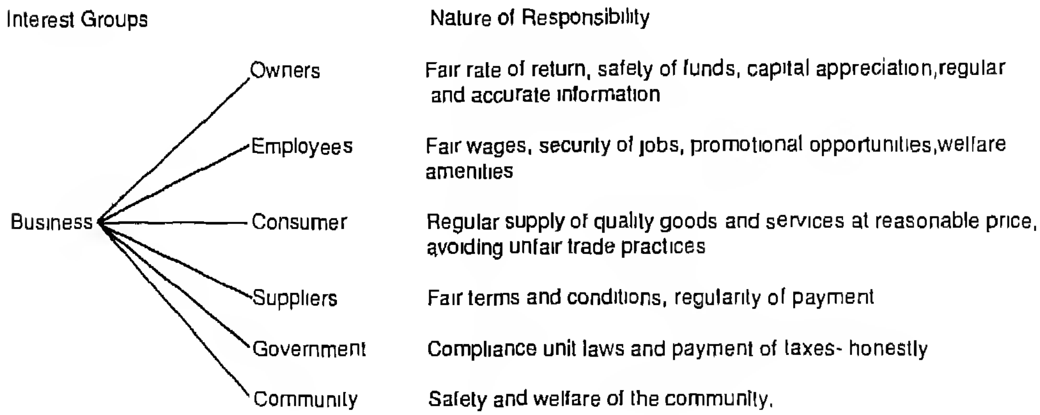

Fig. 2.1

define: (i) what are the characteristics of good business, (ii) what objectives are desirable to be pursued by business, and (iii) how businessmen should conduct their affairs in the interest of society. Thus, for instance, according to the prevailing social values, people consider it bad if a businessman sells defective goods, or uses false weights, or if workers are not paid adequate wages.

From social values are derived certain moral principles, that is, codes of conduct or behaviour of people in society These moral principles may be called social ethics Business ethics refers to the moral principles which should govern business activities in relation to society The most important question arising out of business ethics is this: *Should businessmen aim at making profits by any means?* The answer is 'No'. Business ethics does not permit a businessman to adopt dishonest means for the sake of personal gain. He should charge fair price for the goods He should not cheat the public by selling goods which are not genuine He must disclose to the Government his actual profits and pay taxes as an honest tax-payer. In short, business ethics suggests the ways and means of running a business which are morally justified. It lays down principles governing business practices and regulates the conduct of business affairs. To be honest and truthful, not to cause harm to others for personal gain, are ethical principles. Businessmen are to be guided by such principles This is because in the long run, success of business depends on fair and honest dealings with the public, and adopting practices which are beneficial to society.

SUMMARY

1. Economic and Social Objectives of Business

The main economic objectives of business are (i) earning profit, (ii) creation of customers and (iii) innovation Social objectives relate to (i) supply of desired quality of products at reasonable prices, (ii) avoidance of anti-social practices, (iii) generation of employment and (iv) welfare of employees

2. Characteristics of Business

Some of the important characteristics of business may be listed as (i) sale or exchange of goods and services for the satisfaction of human needs, (ii) dealings in goods and services, (iii) regularity or continuity of dealings, (iv) profit earning, and (v) uncertainty of return or risk

3. Nature and Causes of Business Risks

Business risks refer to the possibility of inadequate profits or even losses due to uncertainties or unexpected events which are beyond control Business risks arise mainly due to (i) uncertainties relating to demand, prices, competition, exchange rates affecting the cost of imports and exports, change in technology, and government control, (ii) unforeseen losses due to theft, fire and other calamities like flood, earthquake, etc , (iii) unexpected events like stoppage of work due to power failure, strikes, and death or departure of a key person, etc , and (iv) factors affecting the availability of funds like changes in interest rates, taxes, etc. But risks are generally unavoidable but some of the risks may be covered by insurance and a few may be shared with others

4. Role of Profit in Business

Earning profit is recognised as the primary objective of business Apart from some other social objectives of business the importance of profit arises from the following

(i) Profit as a source of income provides the means of livelihood for businessmen,
(ii) Part of the profit retained in the business can be used for increasing the volume of business,
(iii) Profit is regarded as an index of performance of those who manage the business,
(iv) Profit is the reward for businessmen who bear the risks of business; and
(v) Profit helps business to gain reputation and goodwill in the market.

5. Case for Social Obligations of Business

Social obligation means the obligation or responsibility of business to act in a manner which will serve the best interests of the society. It is different from legal obligation as it is not covered by law. It relates to the voluntary efforts of businessmen towards the betterment of society. The case for social obligation of business is based on the following arguments

(i) It is in the long-term self-interest of business;
(ii) It increases the public image of business;
(iii) Government control is avoided;
(iv) It is justified on moral grounds;
(v) It is considered necessary due to pressure groups like trade unions and consumer organisations

6. Responsibility towards Different Interest Groups

Responsibility of business towards different interest groups comprises responsibility towards owners, employees, consumers, suppliers, government and the community However, the nature of responsibilities towards different interest groups are different

7. Social Values and Business Ethics

Social values determine what people consider to be good or bad for society. In relation to business, social values define the characteristics and objectives of good business as well as the manner in which business affairs should be conducted. The moral principles derived from social values are called social ethics Business ethics refer to the moral principles which should govern business activities in relation to society.

QUESTIONS

I OBJECTIVE TYPE

Which of the following statements are right and which are wrong?

1 Creation of demand for goods is a social objective of business
2 Generation of employment is the primary economic objective of business
3 Profits are expected to be earned by businessmen in proportion to the amount invested in business

4 Social obligation of business is based on the assumption that what is good for business is also good for society.

5. The primary responsibility of managers of business is towards the owners

II SHORT ANSWER TYPE

1. What do you understand by 'Business Risk'?
2. State the importance of 'profit' in business.
3. Explain briefly the concepts of social values and business ethics

III. ESSAY TYPE

1 What are the main characteristics of business? How will you distinguish between business and non-business activities?

2. Discuss the economic objectives of business. What is the difference between the economic objectives and social objectives?

3. Give reasons to justify why business should assume social responsibilities?

4. Explain briefly the social responsibilities of business towards,
   (i) Employees;
   (ii) Government;
   (iii) Community

5. Write explanatory notes on:
   (i) Social objectives of business;
   (ii) Nature and causes of business risks;
   (iii) Role of profit in business.

CHAPTER 3

Structural Aspects of Business

LEARNING OBJECTIVES

After reading this chapter you will be able to:

1. analyse the influence of environment on business firm;
2. classify the range of business activities;
3. distinguish between different types of industry; and
4. examine the role of commerce as a part of business activity.

3.1 INTRODUCTION

When we talk of structural aspects of business, what immediately comes to mind is the function and role of different types of business activities. Business includes industry, commerce and certain auxiliary activities. These are interdependent They also interact with environment and affect each other

Every business firm has its own environment. No firm operates in isolation It influences the environment and, in turn, is influenced by the environment. There are a number of environmental factors which affect every business firm At the same time, certain specific factors affect particular types of business activities more than others It is therefore necessary to understand the nature of interaction between business and environment The range of business activities in every society has increased over time. There are different types of industries and commercial activities undertaken in modern society. In this chapter, we shall discuss the nature of influence of environment on business activities with reference to the role of industry and commerce in society

3.2 BUSINESS ENVIRONMENT

Business environment may be defined as all those conditions and forces external to a business firm under which it operates Innumerable forces operate outside a business firm (see Fig 3 1) These forces may be divided into two categories. (1) specific external environment and (2) general external environment. Specific external forces such as customers, creditors, suppliers, etc , directly affect a firm. The general external forces exercise their influence in an indirect manner by influencing other forces. For purposes of understanding, the environmental forces may be grouped in different ways. However, the major groups include economic, political and social

The economic environment includes all markets in which business firms buy, sell, raise funds, employ labour, etc The political environment includes political conditions, government, and laws which regulate business activities The social environment is made up of attitudes, desires, expectations, education, beliefs and customs of people Let us understand how each of these factors may affect the operations of business firms.

3.2.1 Economic Environment

It consists of a large number of factors including markets for goods, sources of capital, income levels of people, economic policies of the government, etc. Availability of capital encourages business firms to grow Increase in interest rates discourages borrowing Increase in tax rates acts as a disincentive. Similarly, rise or fall in demand for goods, and rise or fall in prices affect business firms. In fact, activities of firms are invariably influenced by all these factors. Some examples may make it clear:

— During seventies, there was a heavy demand for two-wheelers and scarcity in the market In the early eighties, government changed its policy so as to relax controls over the expansion of automobile industry Now there is no scarcity of two-wheelers
— Some state governments have decided to ban the use of wooden packing cases for fruits as part of their efforts to preserve forests. They are encouraging the use of cardboard containers for this purpose. This policy will help the growth of cardboard producing firms, but at the same time will adversely affect the existing firms manufacturing wooden cases.
— At one time the people in our country had low income. They were satisfied with the bare necessities of life. As a result of rising income of the people, the demand for many luxury goods, radios, TVs, etc has increased.

BUSINESS AND ITS ENVIRONMENT

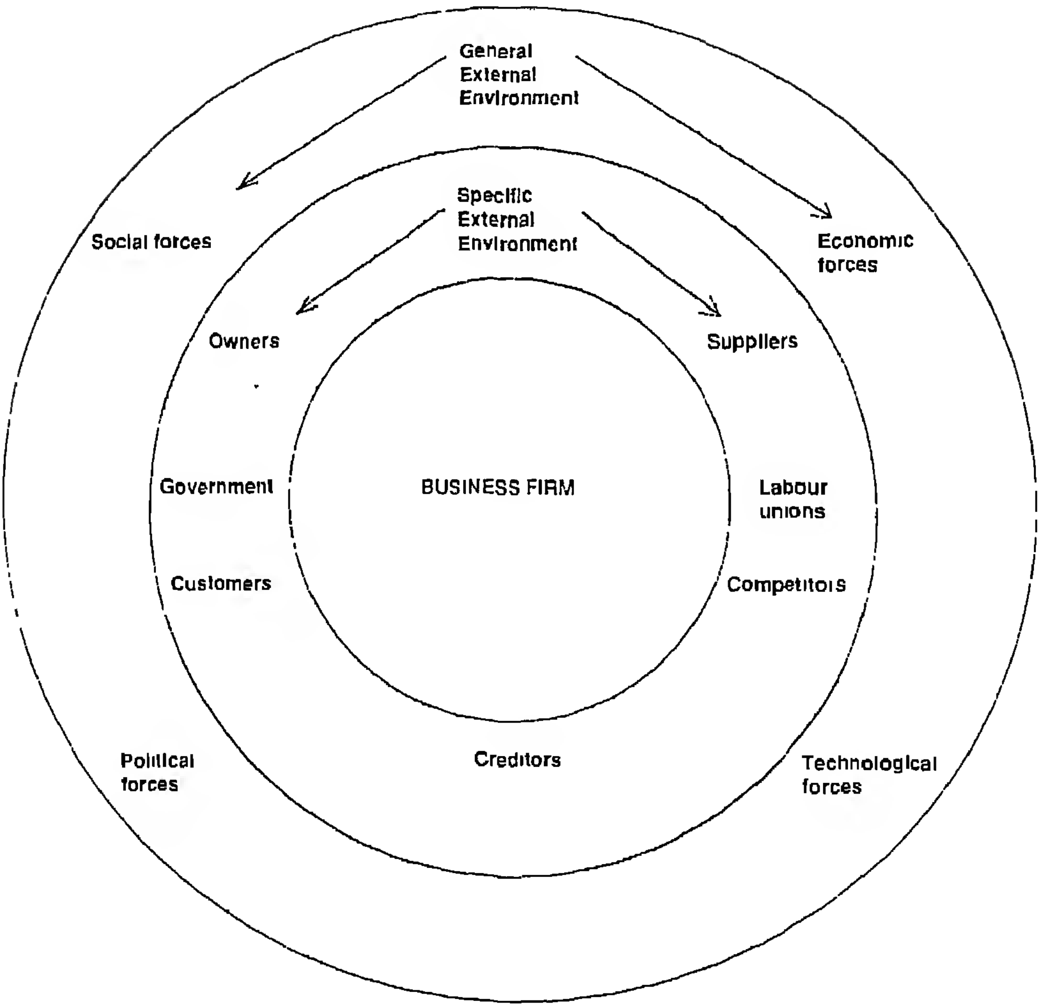

Fig 3 1

3.2.2 Political Environment

Political environment has several connotations. For example, which political party is in power? What is it's ideology? Does a stable government exist? All these questions have a bearing on business. Political peace and stability—both national and international—affect business firms. Bottling and sale of Coca Cola was discontinued in India in the seventies because of the government policy of restricting the growth-of multinational companies in the country. Recently the government has allowed another multi-national company (Pepsi Cola) to enter the Indian market in order to encourage the fruit growing and processing industries.

The influence of political parties in workers' union is also a part of the political environment of the business. Industries are under greater pressure due to the continuing demand of workers for better wages.

Business is affected adversely if there is not stable Government. Thus, for example, political unrest and agitations in North-Eastern India for a number of years halted economic development and business growth in that area.

3.2.3 Social Environment

The nature of goods and services in demand depends upon people's attitudes, education, customs and other social factors.

Since independence, the joint family system in our country is gradually being replaced by small units of families. Women are increasingly being employed in jobs. As a result, the demand for household equipment like refrigerators, electrical gadgets, etc. has increased a great deal. With the growth in numbers of educational institutions, the demand for books and stationery has gone up. The attitudes of people have changed with respect to food and clothing. This has resulted in the development of food processing industries and garment making business. Similar changes in the habits and customs of people in society have influenced the growth of business in different fields. The social factors put together may thus be regarded as an important element of environment affecting business.

3.3 DYNAMIC NATURE OF BUSINESS ENVIRONMENT

Business environment is quite often subject to fast and significant changes. Some of these changes are: (i) increasing government intervention in business, (ii) growing social consciousness, (iii) rapidly changing technology; (iv) growing importance of international business. How these changes influence business activities is explained below.

(i) Increasing government intervention in business. Since the commencement of planning for economic development, regulation and control of private business activities by the Government has continuously increased. Several laws have been passed to control monopolies, restrictive and unfair trade practices, and foreign trade. Besides supply and prices of essential commodities, raising of capital by large enterprises, location of industries, etc. are also regulated by Government in different ways. Above all, a large number of Government enterprises have been established to engage in industrial and commercial activities. Distribution of essential goods has also been undertaken by Government agencies. As a result of all these changes, business firms are no longer free to take decisions without taking into account the legal and administrative controls.

(ii) Growing social consciousness. After independence, the spread of literacy and public consciousness of their rights have contributed a great deal in arousing the aspirations of people. Consumers' expectations have gone up with regard to product quality, safety, price, etc. People are now more concerned about environmental pollution

than ever before. As a result it has become all the more important for a business firm to be responsive to public demands

(iii) Rapidly changing technology: Technological changes are taking place so fast that increasingly large numbers of new products are being introduced in the market Changes in technology has also brought about significant changes in the communication system. As a result, consumers in wider markets can also be informed about new products through mass media These have particularly affected modern industries like those manufacturing engineering goods, electronic equipments and industrial machinery

(iv) Growing importance of international business: Over the years not only has there been a change in the nature of imports and exports, the volume of foreign trade has also grown at a rapid pace The traditional exports from India like tea, jute, cotton have been replaced by engineering goods and sophisticated equipments. Similarly the imports of consumer goods have substantially declined and the imports of steel, machinery and equipment have continuously increased The direction of foreign trade has undergone corresponding changes Foreign trade with U K. has declined with increased volume of trade with the Soviet Union, in terms of value and quantity. In recent years, many collaboration agreements of Indian firms with foreign companies of Japan, West Germany and U S A. have been permitted by the Government in such industries as automobiles, cement and electronic goods. The environment of business has naturally altered with changing pattern of India's foreign trade and foreign collaboration.

3.4 INTERACTION BETWEEN BUSINESS AND ENVIRONMENT

The foregoing discussion clearly brings out the impact of environment on business. A business firm draws money, materials, machines and various other resources from its environment. Any change which affects the price, quality and supply of these inputs will have its effect on the firm Similarly, the output of products and services is offered to the environment The society decides the quantity, quality and the price at which the products and services will be accepted The survival of a firm depends upon the acceptance of its products and services by the environment Thus the environment may be said *to determine the life and death of business* Hence, the linkage between business and its environment is of considerable significance to a business firm It must adapt itself to the environmental changes for survival

The relationship between business and environment can be better appreciated after examining the links among various business activities commencing from production and ending with final consumption

3.5 CLASSIFICATION OF BUSINESS ACTIVITIES

Business activities range from making things available for production of goods to actual production of goods and then, making goods available for consumption by people. These activities may be classified in three ways on the basis of size, ownership or function. These are explained below.

(i) Classification on the basis of size: On the basis of size, business activities are broadly grouped into two categories: (a) small scale, and (b) large scale A small scale industrial unit is one in which investment in plant and machinery does not exceed Rs.35 lakh. In case it is an ancillary unit producing parts or components for a large scale unit, the investment limit is Rs.45 lakh. The concept of small-scale or ancillary unit changes with the change in price level Small units are entitled to certain benefits and privileges as against large scale units. They require less capital, employ small number of workers and produce on a small scale. Goods like ice cream, knitwears,

emergency lamps, bicycle parts, sports goods, and stationery items like pens, pencils, sharpeners, etc. are produced by small units. Large scale units call for substantial investments, which are used to purchase, instal and operate big and sophisticated machineries. They employ a large number of workers and produce on a large scale Iron & steel, cement, petrochemicals and automobile manufacturing units are examples of large scale business.

(ii) Classification on the basis of ownership: Business activities may be broadly grouped into two categories on the basis of ownership: (a) public; and (b) private. If a business is owned by government or any of its agencies, it is known as a *public enterprise*. Where ownership of business is in the hands of persons other than government, it is a *private enterprise*. A few enterprises are owned partly by government and partly by private businessmen directly or indirectly. They are called *joint sector enterprises*.

Private business firms are organised in several forms. They include sole proprietorship, partnership, joint Hindu family, joint stock company, and co-operative society. A public enterprise may be organised as a departmental undertaking, statutory corporation, or government company. Joint sector enterprises are normally in the form of companies.

(iii) Classification on the basis of function: We may classify business activities on the basis of function into two broad categories: (a) industry; and (b) commerce. Industry is concerned with the production or processing of goods and materials Commerce includes all those activities which are necessary for their storage and distribution. On the basis of these two categories, we may classify business firms into 'industrial enterprises' and 'commercial enterprises'. The goods produced by an industrial enterprise may be either for final consumption by consumers or for use in other industrial enterprises. In the former case, they are called *consumer goods*, for example, bread, butter, cheese, sugar, textiles, shoes, radio, TV, etc. On the other hand, production of machinery or machine-tools by an engineering firm are called *capital goods*. It is because they are used by other industrial enterprises for manufacturing consumer goods. Commercial enterprises include trading and service activities like transport, banking, insurance, warehousing and advertising.

Let us examine the activities relating to industry and commerce.

3.6 INDUSTRY AND ITS TYPES

Industry refers to economic activities which are connected with raising, producing or processing of goods and services. In a broad sense, the term 'industry' is also used to mean groups of firms producing similar or related goods and services. For example, cotton textile industry refers to all manufacturing units producing textile goods like cloth, etc. from cotton.

Industries may be divided into two broad categories: primary industries, and secondary industries. Primary industries include all those activities which are connected with the extraction, producing and processing of natural resources. These industries may be further subdivided as follows:

(i) Extractive industries, and
(ii) Genetic industries.

Secondary industries are concerned with the materials which have already been produced at the primary stage The mining of iron ore is primary industry, but manufacture of steel is secondary industry. Secondary industries may be of two types:

(i) Manufacturing industries, and
(ii) Construction industries.

3.6.1 Extractive Industries

Extractive industries are those which involve extraction of something from natural sources like timber from forests, fish from rivers and seas, and

minerals from under the earth Their products include timber, fish and various minerals like coal, iron ore, lime stone, etc. In such cases, the products are either directly consumed or are used as raw materials for further treatment For example fish is often directly consumed, coal is used as a fuel, while minerals are used as raw materials to produce various goods These activities were carried out manually in the past However, with the passage of time, machines have come into use in some of these industries like mining which is highly mechanised

3.6.2 Genetic Industries

These are primary industries which include activities connected with rearing and breeding of animals and birds and growing plants Reproduction and multiplication of certain species is the main activity in these industries. Examples of these industries are.

- Agricultural activities for the production of crops
- Animal husbandry which may include rearing of cattle for milk, grazing sheep for wool and mutton etc
- Dairy farming like using milk from cattle to produce butter, cheese, etc
- Poultry farming which may include raising birds (hens and ducks) for meat and eggs
- Pisciculture, i e. growing fish in ponds, canals and rivers
- Orchards or farms to grow fruit trees of different kinds like apples, cherries, grapes, etc

3.6.3 Manufacturing Industries

Manufacturing industries are secondary industries which convert raw materials into finished products, for example, cotton or jute into textiles, timber into furniture, iron-ore into steel, and so on Essentially, they change the form of goods (raw materials) and, thus, create *form utility* These industries may be run on a small scale using simple tools and equipments or on a large scale using power driven complex machinery.

Manufacturing enterprises produce:

(i) Goods for day-to-day consumption (consumer goods) like cloth, soap, hair oil, stationery, etc.

(ii) Goods which are needed for other production activities (intermediate goods) like steel, cement, chemicals etc

(iii) Capital goods like machinery and equipments which are required to manufacture consumer and intermediate goods

3.6.4 Construction Industry

Activities concerned with building houses for various purposes, and making roads, bridges, dams, seaports, aerodromes, etc. belong to the category of construction industry The peculiar feature of these activities is that their output does not consist of movable goods Construction industries make use of the output of various other industries, like bricks, sand, cement, steel, etc Construction activities are labour intensive by nature. However, in big construction works, the use of heavy machines like cranes, bulldozers, etc , is increasing

3.7 MEANING AND FUNCTIONS OF COMMERCE

Commerce includes all those business activities which are undertaken for the sale or exchange of goods and services and facilitate their availability for consumption and use. Commerce provides the necessary link between producers and consumers. It embraces all those activities which are necessary for maintaining a free flow of goods and services Commerce is thus defined as *activities involving the removal of hindrances* in the process of exchange. The hindrance of persons is removed by traders making available goods to the consumers from the producers. Transport

removes the hindrance of place by moving goods from the places of production to the markets for sale. Storage and warehousing activities remove the hindrance of time by facilitating holding of stocks of goods to be sold as and when required Goods held in stock as well as goods in course of transport are subject to the risks of loss or damage due to theft, fire, accidents, etc. Protection against these risks is provided by insurance of goods. Capital required to undertake the above activities is provided by banking and financial institutions Advertising makes it possible for producers and traders to inform consumers about the goods and services available in the market. Hence, commerce may be said to consist of activities removing the hindrances of persons, place, time, risk, finance and information in the process of exchange of goods and services

It should be clear from the above that the term 'commerce' includes a wide range of activities connected with sale or exchange of goods and services. The functions of commerce, therefore, may be outlined as follows:

(i) The large variety of goods which are produced regularly are meant for consumption by people living in different areas This requires *procurement of goods* from the producers for sale to the ultimate consumers. Traders help the exchange of goods by acting as a link between the producers and the consumers. Trade is indeed the most important branch of commerce as it relates to the transfer or exchange of goods and services Buying and selling of goods which take place in trading activities constitutes the most important function of commerce

(ii) Production of goods is carried out in particular places whereas consumers are scattered in different cities, towns and villages Goods must therefore be moved from the places of production to the various markets. *Transportation* by road, rail and air helps the process of movement without which the sale of goods to consumers would be impossible. Thus, transport is essential for buying and selling of goods, and is an important function of commerce.

(iii) In modern societies, production generally takes place in anticipation of demand. Hence, goods which are produced continuously must be held in stock and made available for sale as and when necessary This function is performed through arrangements for storage of goods in warehouses. Hence, *warehousing* is regarded as another essential function of commerce.

(iv) Insurance of goods and buildings is required to cover the risks of loss or damage due to fire, theft, accident and natural calamities. Traders are able to protect themselves against these risks by insuring goods and buildings on payment of a nominal amount of premium to the insurance company. *Insurance* as a branch of commerce is as important as the others.

(v) Trading activities require funds for procurement and storage of goods before they are transferred. Besides investing their own capital, it is often necessary for them to borrow money. Loans provided by banks and financial institutions are helpful whenever traders are in need of additional funds. *Banking* as a part of commercial activities is actually responsible for increasing the volume of trade

(vi) Consumers must be aware of the variety of goods available in the market before making their purchases. It is therefore necessary that information relating to the goods and services produced must

reach the public. One of the common methods of providing information about goods on sale is *advertising*. As a branch of commerce, advertising helps in bringing all types of goods to the notice of consumers

3.8 TRADE AND ITS TYPES

Trade is an integral part of commerce It refers to sale, transfer or exchange of goods It helps movement of goods from producers. As you know goods are now produced on a large scale and it is impossible for producers to reach individual customers for sale, of their product. Businessmen who are engaged in trading activities act as middlemen to make the goods available to consumers in different markets. It is, therefore, said that goods acquire place utility through trade. In the absence of trade production on a large scale would have been impossible to undertake. The growth of trade has taken place mainly due to increasing volume and variety of goods which are produced in different locations and are meant for sale in distant markets.

Trade may be classified either on the basis of volume of business or on geographical basis For example, when goods are purchased in bulk from the producers it is known as wholesale trade. Those who are engaged in this trade are known as wholesalers. On the other hand, when goods are bought in small quantities either from the wholesalers or manufacturers to be sold to ultimate consumers, it is known as retail trade. Businessmen are known as retailers when they undertake retail trade. Trading activities which takes place within the country is known as inland or domestic trades, whereas goods purchased from or sold to a foreign country is known as foreign trade. If goods are purchased from a foreign country it is called import trade. If they are sold to other countries, it is known as export trade. When goods are imported for export to other countries it is known as Entrepot trade. Let us discuss briefly the nature of various types of trades.

3.8.1 Domestic Trade

Domestic trade consists of sale, transfer or exchange of goods within a country. It is also called internal trade or home trade. This type of trade facilitates movement of goods from points of production to areas where they are needed. Transfer of goods from one region to another region helps to bring uniformity of prices. It also serves a social purpose by creating a feeling of oneness among the people of different regions

Growth of domestic trade depends upon the development of internal transport system—roads, railways, airlines, inland waterways and coastal shipping. Usually, movement of goods takes place by road and rail transport The volume of trade also depends upon the size of population, volume of production, development of banking and other support facilities. Above all, political stability and economic policies of the Government are the other environmental factors which influence the growth of trade

Wholesale trade · Wholesale trade involves buying goods from producers and selling them in small quantities to retailers Wholesalers undertake the responsibility of procuring and storing large quantities of goods for supply to the retailers as and when required by them. The wholesaler serves as an important link between the manufacturer and the consumers through retailers. He provides information to the manufacturers on the demand for goods, customer preferences, etc. For his services, the wholesaler receives commission from the manufacturer on goods purchased

A wholesaler may procure goods from one or more manufacturers, although he may specialise in particular types of products.

Retail Trade Retail trade refers to sale of goods in small quantities directly to consumers. A retailer usually purchases goods from wholesalers Sometimes, he purchases from manufacturers directly. He is a precious link between

manufacturers and consumers. It is he who sells goods to the ultimate consumers He generates good will for a manufacturer and his product. He also communicates the problems of consumers to the manufacturer through wholesaler. Information relating to competing products are known to the producers and wholesalers through the retailer

A retailer may stock different types of goods of the same manufacturer or similar goods of different manufacturers. He may also specialise in a line of goods e g. foodgrains, hooks, stationery, leather products, etc.

3.8.2 Foreign Trade

Foreign trade consists of trade among different countries It involves import and export of goods. It facilitates countries to specialise in the production of goods for which they have maximum relative advantage. This helps all trading countries derive the benefits of specialisation. The movement of goods takes place usually by sea wherever possible. In adjoining areas, rail and road transport may be used. Air transport is used for goods of small bulk and high value

Foreign trade—import or export—depends upon government policies in the trading countries and usually requires a number of formalities to be completed. There are restrictions imposed on free entry of goods and duties and taxes are to be paid Besides, the foreign exchange earned by an exporter has to be surrendered to Reserve Bank of India in exchange of Indian currency. On the other hand, importers have to obtain foreign exchange from the Reserve Bank of India. Violation of laws relating to import, export or foreign exchange entails punishment

In India, we have certain government agencies which undertake foreign trade in bulk, for example, the State Trading Corporation (STC), Minerals and Metals Trading Corporation (MMTC), etc. A developed banking system is very useful in foreign trade. Our commercial banks provide numerous services to the importers as well as the exporters. Government policies are also in favour of export promotion.

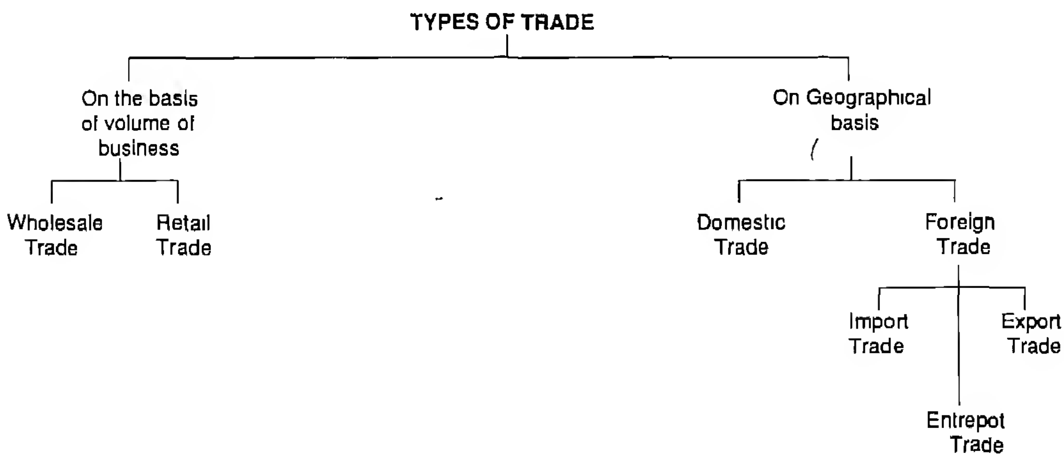

Fig. 3.2

3.9 AUXILIARIES TO BUSINESS ACTIVITY

The term 'auxiliaries to business' mean subsidiary activities assisting business. Transport, banking, insurance, warehousing, and advertising are regarded as auxiliaries i e activities playing supporting role to trade. In fact, these activities not only support trade but also industry and hence, the entire business activity. However, auxiliaries are an integral part of commerce in particular and business activity in general. These activities help in removing various hindrances which arise in connection with the production and distribution of goods. Transport facilitates movement of goods from one place to another. Banking provides financial assistance to the traders. Insurance covers various kinds of business risks. Warehousing creates storage facility. Advertising provides information. In other words, these activities facilitate movement, storage, financing, risk coverage and sales promotion of goods. Auxiliaries are briefly discussed below.

3.9.1 Transport

Production of goods generally takes place in particular locations For instance, tea is mainly produced in Assam, cotton in Gujarat and Maharashtra, jute in West Bengal and Orissa, sugar in U P., Bihar and Maharashtra, and so on. But these goods are required for consumption in different parts of the country The obstacle of place is removed by transport — road, rail or coastal shipping. Transport facilitates carrying of raw materials to places of production and the finished products from factories to places of consumption.

Alongwith transport facility there is also need for communication facilities so that producers, traders and consumers may exchange information with one another. Thus post and telegraph services and telephone facilities may also be regarded as auxiliaries to business activities.

3.9.2 Banking

Business activities cannot be undertaken unless funds are available for acquiring assets and meeting the day to day expenses. Necessary funds can be obtained by businessmen from banks. Thus, banking helps business activities to overcome the problem of finance. Commercial banks generally lend money by providing overdraft and cash credit facilities. Banks also undertake collection of cheques, remittance of funds to different places and discounting of bills on behalf of traders. In foreign trade payments are arranged by commercial banks on behalf of importers and exporters. Commercial banks also help promoters of companies to raise capital from the public.

3.9.3 Insurance

Business involves various types of risks. Factory building, machinery, furniture etc. must be protected against fire, theft and other risks Materials and goods held in stock or in transit are subject to the risks of loss or damage Employees are also required to be protected against the risks of accident and occupational disease. Insurance provides protection in all such cases On payment of a nominal premium, the amount of loss or damage and compensation for injury, if any, can be recovered from the insurance company

3.9.4 Warehousing

Usually goods are not sold or consumed immediately after production. They are held in stock to be available as and when required. Special arrangements must be made for storage of goods to prevent loss or damage.

Warehousing helps business firms to overcome the problem of storage and facilitates the availability of goods when needed Prices are thereby maintained at a reasonable level through continuous supply of goods.

3.9.5 Advertising

Mass consumption goods of daily use like sugar, salt, soap, edible oil, textiles, toothpaste, paper, pen etc , are manufactured and supplied in the market by numerous firms — big or small. It is practically impossible for producers or traders to contact each and every consumer. Thus, for sales promotion, information must reach the potential buyers about the goods available in the market Goods are advertised to inform consumers about their uses, quality, price etc Advertising thus helps in providing information about available goods and inducing consumers to buy particular items.

SUMMARY

1. Business Environment

Business environment may be defined as all those conditions and forces external to a business firm under which it operates. The environmental forces may be divided into two categories (i) specific external environment and (ii) general external environment Specific external forces directly affect a firm. The general forces excercise their influence in an indirect manner by influencing other forces.

For purposes of understanding the environmental forces may be divided into three groups — economic, political and social Economic environment consists of a large number of factors including markets for goods, sources of capital, income levels of people, economic policies of the Government etc Political environment include forces connected with the ideology of the political party in power, national and international political conditions, etc Social environment refers to conditions, determining people's attitudes towards living standards, level of education, social customs and other social factors

2. Dynamic Nature of Business Environment

Business environment is quite often subject to fast and significant changes The changes may involve (i) increasing government intervention in business, (ii) growing social consciousness, (iii) changes in technology, and (iv) growing importance of international business Since the commencement of planning for economic development, regulation and control of private business activities by the Government has continuously increased Besides, a large number of government enterprises have been established to engage in commercial and industrial activities The spread of literacy and consumers expectations about product quality, safety, etc have resulted in growing consciousness of the public regarding their rights The importance of foreign trade has increased over the years leading to a larger volume of imports and exports as well as changes in the composition and direction of trade

3. Interaction between Business and Environment

The linkage between business and its environment is of considerable significance to a business firm It must adapt itself to environmental changes for survival and growth.

4. Classification of Business Activities

Business activities may be classified on the basis of function, size or ownership Functionally classified, business may be divided into two broad categories· (i) industry, and (ii) commerce On

the basis of size, business activities may be grouped under two categories (i) small scale, and (ii) large scale Business activities may also be grouped into two categories on the basis of ownership, i e (i) public and (ii) private A public enterprise refers to business which is owned by Government or any of its agencies Where ownership is in the hands of persons other than Government, it is a private enterprise

5. Industry and Its Types

Industry refers to economic activities which are connected with raising, producing or processing of goods and services. Industries may be divided into two broad categories. (i) primary industries, and (ii) secondary industries Primary industries may be further subdivided into two groups (i) extractive industries, (ii) genetic industries. Similarly, secondary industries may be divided into two groups. (i) manufacturing industries and (ii) construction industries

6. Meaning and Function of Commerce

Commerce includes all those business activities which are undertaken for the sale and exchange of goods and services and facilitate their availability for consumption needs It involves the removal of hindrances in the process of exchange through trade, transport, banking, insurance, warehousing and advertising

7. Trade and Its Types

Trade is an integral part of commerce and refers to sale, transfer or exchange of goods. On the basis of volume of business, trade may be classified as (i) wholesale trade, or (ii) retail trade. On geographical basis, trade may be classified as domestic trade and foreign trade Foreign trade may include import, export and entrepot trade

8. Auxiliaries to Business Activity

Transport, banking, insurance, warehousing and advertising are regarded as auxiliaries to business, i e activities which support trade as well as industry The auxiliaries are an integral part of commerce in particular and business in general

Transport facilitates movement of goods from the places of production to the markets Communication facilities are also needed for exchange of information between producers, traders and consumers Banking helps business activities by providing financial assistance and other services like collection of cheques, remittance of funds within the country as well as outside Various types of risks which are involved in business can be covered by insurance of properties and goods Protection of employees against the risk of accident, etc can also be covered by insurance. Warehousing helps business firms to overcome the problem of storage and facilitates the availability of goods when needed. It also prevents price fluctuations through continuous supply of goods. Advertising provides information to the consumers about the availability, uses and quality of goods to induce them to buy particular goods.

QUESTIONS

I. OBJECTIVE TYPE

Fill in the blanks:

1. Business is a __________ institution (government, private, social)
2. A small scale industrial unit is one in which investment in plant and machinery does not exceed ____________ (Rs. 30 lakh, 35 lakh, 45 lakh).
3. Business risks may be ____________ through insurance (optimised, avoided, minimised)
4. ________________ bank helps in foreign trade. (Central, State, Foreign Exchange)
5. The foreign exchange earned by an exporter has to be surrendered to the ________________ (Government, Reserve Bank, State Bank)

II. SHORT ANSWER TYPE

1. What do you mean by business environment?
2. Distinguish between 'general external environment' and 'specific external environment'.
3. Distinguish between a small scale industrial unit and a large scale industrial unit
4. Is dairying a genetic or extractive industry? Give reasons.
5. Is furniture making extractive, manufacturing or construction industry? Give reasons.
6. Distinguish between wholesale trade and retail trade
7. Bring out the role of transport in business activity
8. Do you agree with the suggestion that business environment is undergoing fast and significant changes? If so, give examples.
9. State the functions of a commercial bank.

III. ESSAY TYPE

1. Why do we insure goods?
2. How does warehousing facilitate trade?
3. How does advertising create demand?
4. Discuss how environmental forces and business activities inter-related.
5. Give some examples to show how a change in environment may pose a threat or offer an opportunity to a business firm
6. Discuss various ways in which business activities may be classified. Give examples based on functional classification of business activities
7. What do you mean by auxiliaries to business? Discuss their significance for the growth of industries and trade
8. "Business is what it's environment has made it" Discuss.

CHAPTER 4

Service Sector and Business

LEARNING OBJECTIVES

After reading this chapter you will be able to:

1. identify the modes of transport;
2. explain how commercial banks and other financial institutions are useful to business firms;
3. describe how business risks can be covered;
4. identify the function of warehouses;
5. recognise the significance of packaging; and
6. analyse the role of advertising in sales promotion.

4.1 INTRODUCTION

In the previous chapter, we have discussed the nature of different types of business activities and the auxiliaries to business which support those activities It would be useful to examine in detail the types of services which are rendered by the auxiliaries to business activities Production requires supply of raw materials, as well as distribution of goods in different markets.

The process of production and distribution involves transportation, banking, insurance and other service activities. Business firms are engaged in providing all these services to facilitate production and distribution of goods The activities of these firms taken together constitute the service sector of the economy This is also known as the tertiary sector.

4.2 NEED FOR SERVICE FACILITIES

Industry and trade— the two main branches of business activities — include manufacturing and production of different varieties of goods and services as well as their marketing for consumption and use. Modern industries are characterised by production on a large scale in anticipation of demand. Similarly distribution of goods in different markets consists of buying and selling in large quantities In fact, large scale production and distribution make it possible for businessmen to run their activities more economically Service facilities like transport, insurance, warehousing, etc. are required to be arranged for better production and marketing of goods Provision of these facilities has also become specialised. These could be taken up by producers and traders themselves. But in that case it would be highly expensive. Hence, separate categories of business have developed to undertake the service activities. Small scale producers and traders with limited resources cannot arrange all the service facilities on their own. Large scale producers and traders also find it more economical to use the service facilities provided by other business firms

The need for these facilities arises from the nature of production and distribution Production takes place on a large scale in a limited number of places The goods and services produced are required to meet the needs of consumers scattered over large territories. Hence, transportation is an essential service which provides the facility of movement of goods Production in anticipation of demand and regular supply of goods in the markets require storage facilities. Business activities require investment of funds for purchase of assets and day-to-day expenditure. Financial assistance for all these purposes is provided by banks

Risks of loss or damage are natural factors which are associated with storage and transportation of goods Protection against the business risks is possible through insurance Goods produced in bulk need to be put in convenient packages for easy handling and exchange in the process of distribution

Since goods and services are produced on a large scale, their availability, use, quality, etc. must be known to the ultimate consumers Information relating to goods available is provided through advertisements sponsored by producers and traders. It is obvious, therefore, that without the service facilities of transport, storage, banking, insurance, etc. the system of production and distribution cannot be efficient.

4.3 CLASSIFICATION OF SERVICE FACILITIES

The service facilities which are of vital importance to both industry and trade may be classified as follows:

(i) Transport
(ii) Banking
(iii) Insurance
(iv) Others (Warehousing, Packaging, Advertising and Sales Promotion).

All these facilities are explained in detail below

4.4 TRANSPORT

Transport refers to the means of physical movement of goods and passengers The means of transportation may consist of roadways, railways, waterways, airways and even pipelines for oil Physical distribution of raw materials from the areas of production to the factory sites is a vital necessity for manufacturing goods. Similarly, the movement of finished goods from the production centres to the various markets for sale is an equally important necessity. Moreover, people who provide various services also have to travel to different places where their services are required

Transport creates 'place utility' and removes the problem of distance by transferring goods from places of production to places of consumption With development of modern transport systems all kinds of goods can be moved in large quantities over long distances. Growth of industries has thus been possible in different areas. Transfer of goods on a large scale is also possible to meet the needs of consumers in distant markets not only within a country but also in foreign countries. Besides the economic benefits derived from transport facilities there are also various social and political advantages which accrue as a result of the modern means of transport.

Several functions which are performed by the transport services are outlined below:

(i) Widening of markets Transport makes it possible to supply goods in markets which are far away from the production centres. For example, tea is produced in Assam and West Bengal, but consumed all over the country and even abroad. So is the case with many other products. Thus transport helps in widening the markets for goods. Development of transport linking the seaports with other parts of the country has contributed a great deal in increasing the volume of India's [illegible]de.

(ii) Large scale production As a consequence of the widening of market it is possible for production of goods to be undertaken on a large scale. Besides, movement of machinery and large scale transfer of raw materials facilitate the growth of manufacturing enterprises.

(iii) Mobility of resources Mobility of men, materials and machinery is essential for large scale production and developing backward regions in a country. Since transport facilitates movement of all types of resources, it is not necessary to establish industries near the sources of raw materials or the markets. Factories can be located in any region due to the available means of transport

(iv) Specialisation. Within a country, particular regions are suitable for producing certain types of goods but may not be equally suited for the production of other types of goods. Thus, it may be economical for a region to concentrate only on the production of goods for which it has greater comparative advantage. It can depend on transport to meet the requirement of other types of goods from other regions while, supplying its surplus production to other areas Transport thus facilitates geographical specialisation within a country. Likewise it is because of transport facilities that particular countries may specialise in the production of goods for which there are greater advantages as compared with other countries.

(v) Price stability: An efficient transport system helps in maintaining price stability. Goods may be moved at short notice from places of abundance to places of scarcity. For example, if there is shortage of foodgrains in a State due to failure of crops it is possible to supply necessary quantities and thus prevent rise in prices of foodgrains in that State.

(vi) Reduction of congestion in cities Location of manufacturing plants in big cities leads to higher density of population and congestion Facilities available cannot cope with the concentration of people in big cities. It has become

possible for manufacturers to set up their plants away from the big cities due to the availability of efficient means of transport Thereby, congestion in big cities has been reduced to a great extent Similarly, it is now possible for people to live in the suburbs of big cities and avail of local transport to travel daily from their residence to their places of work

(vii) Social benefits As transport facilitates the location of industries in backward regions it helps the people of those regions with opportunities of employment The living standards of people also improve as a result of various other occupations which can be adopted by the people. Secondly, movement of people between different regions helps to bring about closer cultural ties not only within a country but also with people in other countries Thirdly, the security and defence of a country depends a great deal on the system of transport for movement of defence forces and equipments.

There are different modes of transport available for the movement of goods and passengers. The more important means of transport by land, water and air are shown in Fig. 4 1. Land transport includes roadways, railways and pipelines. Water transport includes inland waterways and ocean transport; and air transport consists of domestic airlines and international airlines.

4.4.1 Land Transport

The different modes of land transport are described below

Road Transport

It is the oldest means of transport In early days, human beings and animals were ordinarily used for carrying goods. Their use is still common in hilly areas. In the plains, farmers depend heavily on bullock carts for carrying agricultural products. However, road transport now consists largely of motor cars, buses and trucks. The network of roads in India is one of the largest in the world There are national highways, state highways, district and village roads Ready availability, speed, flexibility and quality of service have led the people to prefer road transport, especially for travel or carriage of goods over short distances For long distances, there is competition between roadways and railways

Apart from buses and trucks, there exist a large number of other road carriers like cycle rickshaws, auto-rickshaws, four-seaters, tempos and taxis These modes of transport carry persons as well as goods. These carriers have route flexibility, provide door to door service and journey at will These are privately owned and operated and are often found in urban areas.

Merits of road transport

(i) It is flexible as regards time and route and provides door-to-door service
(ii) It facilitates movement of people to and from remote areas where other means of transport are not available.
(iii) It provides numerous alternatives—bullock carts, thelas, cycles, tongas, rickshaws, cars, taxis, buses, trucks, etc
(iv) It is useful for quick transportation of perishable products like milk, vegetables, etc., from villages to cities.
(v) It requires lower capital investment and maintenance cost as compared with other means of transport.
(vi) It supplements transportation by other means

Limitations of road transport

(i) It is not economical for long distance transportation of goods due to the limited carrying capacity.
(ii) It is slow as compared to railways where long distance is to be covered.
(iii) Goods are liable to deterioration due to the

effect of dust, heat and rain.

(iv) During rainy season, use of road transport is restricted on account of : (i) flooding of roads, and (ii) deterioration in their condition

Railways

In India the railways are owned and operated by the Central Government. They occupy an important place in the inland transport system. The railway routes are spread over all parts of the country. A large number of trains carry either goods or passengers Some of them carry both. Railways are the most important carriers of goods traffic within the country.

Merits of rail transport

(i) It is economical for transport over long distances.

(ii) It is faster than roadways and inland waterways

(iii) It is most suitable for carrying bulky goods.

(iv) Its carrying capacity is large which may be suitably adjusted by increasing or reducing the number of wagons

(v) Its services are least affected by weather conditions, though floods sometimes create problems.

(vi) It provides protection from exposure to sun and rain except in the case of open wagons or rakes.

Limitations of rail transport

(i) Rail transport suffers from lack of flexibility. Railway tracks are laid in advance and there cannot be any change at short notice. Moreover, trains follow a fixed time schedule.

(ii) It involves huge capital outlay for construction, maintenance and other expenses.

(iii) Rail transport cannot be easily developed in hilly regions and desert areas

(iv) Under utilization of capacity in any region leads to a huge financial burden In certain regions railways cannot be profitably run due to inadequate goods and passenger traffic.

Rail-road co-ordination

The merits and limitations of rail transport show that it is suitable under certain conditions. So is the case with road transport. Taken together road and rail transport may be regarded as complementary services. Roadways and railways sometimes compete for passengers and goods traffic where the same area is served by both.

Since roadways and railways may provide complementary services coordination is essential in their development and operation. It is, therefore, felt that road transport should provide feeder services to the railways. In other words, road transport should be developed in areas which are not served by railways so that goods and passengers may conveniently reach the railway terminals and stations for onward movement

Pipeline transport

Pipelines are generally used for transportation of liquid petroleum products, natural gas or coal gas In India, there are long stretches of pipelines laid for transport of crude oil from the oil field to the refineries and the petroleum products from the refineries to the distribution centres As a means of transport pipelines are the cheapest if the volume to be transported is large.

Merits of pipeline transport

(i) It is most suitable for transporting natural oil and gas

(ii) It is more economical than road or rail transport for transporting liquid petroleum and gas

(iii) It is the only means of transport available

for natural gas and coal gas on a large scale

Limitations of pipeline transport

(i) Pipelines cannot be used for transportation of anything other than liquid oil and gas
(ii) It requires heavy expenditure for installation and maintenance of pipelines as well as pumping stations.

4.4.2 Water Transport

Water transport involves the use of rivers, canals, and the sea. Normally, boats, ferries, steamers, etc. are used in inland waterways that is rivers and canals. Ships are used in sea transport Moving goods and passengers from one part of the country to another by ship is called coastal shipping Transport of goods and passengers to other countries is called overseas shipping.

Inland waterways

To be useful as a means of transport, inland waterways should be navigable throughout the year. However, many of the rivers and canals are not navigable due to inadequancy of water during the dry seasons Inland waterways exist in only a few states like Andhra Pradesh, Assam, Goa, Tamil Nadu and West Bengal. The total passenger and freight traffic carried by inland waterways is negligible.

Merits of inland waterways

(i) They do not involve heavy expenditure for maintenance
(ii) They are most suitable for transporting bulky but less costly goods like coal, timber, jute, etc.
(iii) They are relatively more economical as regards the cost of transport.

Limitations of inland waterways

(i) They are slow and not suitable for perishable goods.
(ii) They can serve only those areas which are located on the banks of the waterways They cannot directly serve the interiors
(iii) Seasonal factors may restrict the use of waterways. For example, during summer, the water level may be too low for navigation; during rainy season, floods may disrupt the transport; and during winters, the waterways may be frozen at certain places
(iv) Their carrying capacity is relatively less than that of railways.

Ocean transport

Ocean transport represents the oldest form of transport for movement of goods and people across high seas and oceans. It is most useful for trade among countries connected by sea Overseas transport is carried out by definite routes, which link almost all countries of the world. It is also useful for coastal transport in the case of countries having navigable shores and port facilities

Coastal shipping is highly developed in India. There are 165 minor and medium ports along India's 6000 kms coast line There are ten major ports — Bombay, Calcutta, Cochin, Kandla, Madras, Marmugao, Paradip, Vishakhapatnam, New Mangalore and Tuticorin and four major ship-building yards. Coastal shipping is used to move foodgrains from the west to the south via the west coast, and coal from the north to the south via the east coast.

Merits of ocean transport

(i) It is the cheapest means of transport
(ii) Goods may be transported in bulk
(iii) It promotes international trade.

Limitations of ocean transport

(i) It is a relatively slower means of transport

and therefore not suitable for transport of perishable goods.

(ii) In certain parts of the world oceans are not navigable due to seasonal changes.

(iii) It is subject to the risks arising out of the perils of the sea like storms, enemy attack, etc.

4.4.3 Air Transport

Introduction of airways as means of transport is a relatively new phenomenon The two principal features which give it a distinct advantage are. (a) speed, and (b) its suitability where surface transport is lacking. It is advantageous in situations where speed is desired; or where the surface conditions are such that land transport and water transport are slow, dangerous or expensive

Air transport is especially useful for the transport of less bulky goods of high value Since it is of particular advantage over longer distances, countries having extensive geographical areas develop domestic air services, as in the U.S.A , Canada, U S.S R., and India. In India, the Indian Airlines Corporation is concerned with domestic flights while international flights are operated by Air India International Corporation With the growing prosperity of people and time being an important consideration people have started relying more on air transport than rail transport However, air passenger traffic and air goods traffic in our country still constitute only an insignificant part of the total traffic in the country.

Merits of air transport

(i) It is the fastest means of transport, especially for long distances.

(ii) It is very useful for moving costly goods of small bulk

(iii) It is very useful in transporting goods to areas which are not accessible to other means of transport.

(iv) It is vital for the national security and defence

(v) It is more suitable when other means of transport are disrupted due to flood, earthquake etc.

Limitations of air transport

(i) It involves large capital investment and high operating costs

(ii) It is not suitable for bulky and low priced products because freight charges are high

(iii) It is highly uncertain and unreliable as the services depend on favourable weather conditions. Flights may be postponed or cancelled due to rain, fog, etc.

(iv) The risk of accident is the highest in air transport

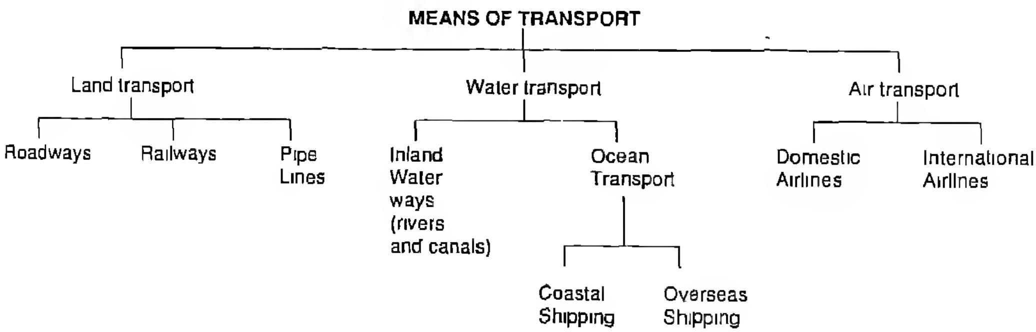

Fig. 4 1

Requirements of a good transport system

The suitability of any particular mode of transport depends on (i) its services from the user's point of view, (ii) profitability from the operator's point of view, and (iii) utility from the point of view of society.

Users' point of view: Users may be divided into two broad categories — business firms, and the general public. Their expectations may be similar in certain respects. For example, they may expect it to provide dependable service, comfort, safety, speed and low cost. However, the degree of importance attached to these factors may differ with the two categories of users. Business executives may prefer more comfort and speed even at a higher cost. On the other hand, the general public may be prepared to forgo comfort and speed for the sake of lower cost Of course, none will like to compromise safety

For goods transport, users generally expect speed, flexibility, dependability and low cost Again, the importance of the factors may be different with respect to the transport of different types of goods For example, speed may be the prime consideration in the case of costly perishable products But safety may be most important in the case of inflammable products like petroleum

Operators' point of view Transport services may be provided by government, private firm, or individuals For all operators making profit is the most important consideration. However, the Government may operate transport services at subsidised rates in the public interest

Society's point of view. The society looks for a system which is accessible to all areas, involves least pollution and noise, and facilitates mobility of people. The relative importance of these factors may, however, vary depending upon the mode of transport.

4.5 BANKING

No business activity can be undertaken without provision of adequate capital Whether it is industry or trade funds are required not only for the acquisition of fixed assets but also for financing day-to-day operations. The volume of business actually depends a great deal on the availability of finance The problem of financing any business activity arises mainly because receipts of cash take place at different times whereas operating expenses have to be incurred regularly. Besides, holding stocks of raw materials and finished goods involves investment of funds for different periods of time Banking helps business firms to overcome the problem of finance by lending money as and when required. Essentially banks receive deposits of money from business firms as well as the general public. The deposits are withdrawable by cheque or draft. Banks extend loans and credits for business purposes on the basis of deposits received from the public. The role of banking in modern times is not only confined to receiving deposits and making loans but also includes various other services rendered by banks. With the rapid growth of business activities importance of banking has increased all the more.

Definition. Banking refers to the business of accepting deposits and lending money. The deposits are repayable on demand and withdrawable by cheque or draft. On the basis of deposits received banks lend money for various purposes. Interest is paid on deposits and charged on loans and credits. Besides accepting deposits and lending money banks render various other services like collection and payment of bills, remittance of funds, locker facility, safe custody of valuables, etc Thus a bank may be defined *as an institution which is engaged in accepting deposits, making loans and providing other services to its customers and the general public.*

4.5.1 Commercial Banks

Commercial banks are the most important type of banks helping industry and trade. They accept deposits from individuals, firms and other institutions and the same are withdrawable by cheque at short notice. Since their funds consist of short term deposits payable on demand, their lending also consists of advances for short periods.

In India, there are twenty nationalised commercial banks. Others are in the private sector. Both are subject to the regulation and control of the Reserve Bank of India. Since their nationalisation, the major commercial banks have increased the number of branch offices so as to cover every part of the country

Functions: The functions of commercial banks include the following five types of activities:

(i) acceptance of deposits, (ii) grant of loans, (iii) discounting of bills, (iv) acting as agent, and (v) offering miscellaneous services.

(i) Acceptance of deposits This is the most important function of commercial banks. Banks accept deposits on different conditions and accordingly pay interest Bank deposits may be divided into the following categories of accounts' (a) fixed deposit account; (b) savings account, (c) recurring deposit account; and (d) current account. These deposits are accepted from individuals, firms and other institutions

(a) Fixed deposit: When money is deposited for a fixed period it is known as fixed deposit or term deposit. Such a deposit cannot be withdrawn before the expiry of the period The rate of interest paid on this types of deposit varies according to the duration of the time period

(b) Savings account. Generally small savers and salaried people open savings account. Banks usually impose certain restrictions on the number and amount of withdrawals but deposits can be made any number of times. The rate of interest paid on this account is relatively lower than that on fixed deposits

(c) Recurring deposit In this case, money is deposited at regular intervals and the whole amount deposited is repayable on the expiry of a fixed period of time. The rate of interest payable is similar to that applicable to fixed deposits

(d) Current account: These accounts are usually opened by businessmen who deposit money and make payments by cheque. One may operate such an account a number of times during the day. Obviously no interest can be paid on balances in such accounts. On the other hand, some banks charge a small fee called 'bank charges' or 'incidental charge'

(ii) Grant of loans. Banks lend money on the basis of deposits received. Loans are granted on the security of goods or assets or against personal security Banks are able to pay interest on deposits out of the interest earned on loans and advances Loans and credits are extended in the form of over-drafts, cash credits, or loans and advances.

Lending of money is a permanent function of banks Usually they do not lend hard cash Most of the borrowings of customers consist of the rights to draw cheques. Lending is done at a profit which is necessary for the very existence of banks. They also lend at concessional rates of interest to certain priority borrowers like small agriculturists, retailers, students and handicapped persons.

(a) Over-draft It is a temporary arrangement in the form of a permission granted to the customers to overdraw their current accounts upto a sanctioned limit. Interest is charged only on the amount actually utilised.

(b) Cash credit Cash credit is like over-draft arrangement, but for this purpose a current account does not have to be in existence. In such credit, a trader or industrialist or agriculturist can withdraw amounts within the limits sanctioned for meeting expenses on current operations. In such cases interest is paid on amounts withdrawn.

(c) Loans and advances· In this case the entire amount is paid to the borrower in lump-sum

either in cash or by way of transfer to his current account. Interest is charged on the whole amount of loan whether it is withdrawn or not.

(iii) Discounting bills of exchange: Banks discount bills of exchange of their customers. On the request of a customer, bank takes a bill and credits his account with the bill amount minus discount charges. When the bill matures, the bank presents it to the acceptor. He makes the payment to the bank. If the bill is dishonoured on account of non-payment, the bank recovers the full amount from the customer. In such a case, bank also charges the incidental expenses incurred by it.

(iv) Acting as agent: Acting as agent, banks render useful services to customer. Among others, these services include

— collection of payments on cheques, drafts, bills, hundies etc.;
— sending money from one place to another;
— accepting children's school fee;
— realising dividends on shares;
— buying and selling securities;
— payment of insurance premium; and
— agreeing to act as referees on behalf of customers in connection with internal as well as external trade.

(v) Miscellaneous services: A number of miscellaneous services are also rendered by banks to persons, who may or may not be regular customers. These include:

— issuing travellers' cheques, pay orders and bank drafts;
— safe custody of important documents;
— underwriting of shares and debentures of companies;
— accepting telephone and other bills;
— providing credit information of customers to their creditors.

4.5.2 Other kinds of Banks

Besides commercial banks, there are several other kinds of banks which have developed in India over the years.

1. Agricultural banks: Agricultural banks are of two types (i) co-operative banks, and (ii) land development banks. The object of these banks is to assist agriculturists with short term as well as long term loans. Usually loans are given by co-operative banks for purchase of oxen, plough, seed, fertilisers, etc. Land mortgage banks now known as land development banks, provide long term funds for purchase of land or making permanent improvements in land.

2. Indigenous bankers: Before independence, lending of money for agricultural and other purposes in rural areas was largely controlled by individuals known as indigenous bankers. These bankers did not follow modern banking practices and charged high rates of interest due to the absence of other lending institutions. Their role in the rural banking system is still significant. It is because of certain peculiar features, (i) they are not concerned with the purpose of loans, (ii) they lend even without any security; (iii) they are readily available, and (iv) no procedural formalities are involved.

3. Regional rural banks: Regional rural banks were established for the first time in 1975. They sought to combine the more positive features of the co-operative and commercial banking systems. They depend on the sponsorship of particular commercial banks which provide resources and support them. The Central Government has specified the local limits (one or two districts) within which a regional rural bank has to operate. Their lending operations are oriented towards meeting the needs of the weaker sections of the rural population. They include small and marginal farmers, agricultural labourers, artisans and small entrepreneurs. Financing other categories of borrowers is exceptional. Loans may be given individually or in groups, but within the notified area.

4. Exchange banks: These banks finance foreign

trade They deal in transactions involving foreign exchange Most of these banks are of foreign origin Major exchange banks operating in India are: the Chartered Bank, Grindlays Bank, Bank of Tokyo and Bank of America.

5. Central bank: The Central Bank of a country is an institution which regulates the banking system It prescribes the rates of interest payable on loans and deposits. It regulates money and credit supply as also foreign exchange transaction and lends money to other banking institutions when necessary Besides, the Central Bank acts as Government bankers and maintain government accounts The Central Bank of our country is the Reserve Bank of India.

6. Development banks: Commercial banks generally advance money for short periods against the security of movable goods These banks do not grant long term loans or provide capital which may be required for the construction and acquisition of fixed assets in large-scale enterprises Special financial institutions were thus required to meet the financial needs of industry in the form of long term capital A number of special financial institutions have been established since independence for that purpose These include Industrial Finance Corporation of India (IFCI), Industrial Credit and Investment Corporation of India (ICICI) and Industrial Development Bank of India (IDBI), which are national level institutions. Besides, the State governments have also set up similar institutions, such as the State Finance Corporations (SFCs) and State Industrial Development Corporations (SIDCs). These financial institutions are known as Development Banks. The characteristic feature of development banks is that they provide long term financial assistance only in the case of new enterprises and for expansion and modernisation of existing enterprises. Moreover, they act only as gap fillers i.e assistance is provided when an enterprise is unable to raise capital from other sources.

4.6 INSURANCE

All types of business activities are subject to risks of loss or damage due to unforeseen events which are beyond the control of businessmen. Loss or damage may arise due to fire, theft, natural calamities like flood or earthquake and so on. People employed in business firms are also liable to the risks of injury or loss of life due to accidents in the work place Business firms are able to provide for protection against these risks by insurance They can cover the risks on payment of a nominal premium and recover the loss if any, arising out of the risks

Insurance is defined as an agreement between two parties whereby one of them called *insurer*, agrees to protect the other known as *insured*, against a loss which may arise on the happening of an event. The document containing the agreement is called 'the policy'. In consideration for the insurer's promise to protect the insured from loss, the insured agrees to pay an amount of premium either in lump-sum or in instalments at regular intervals.

The idea of insurance is based on social cooperation The loss suffered by any one insured is spread among a large number of insured who contribute small amounts of premium. The premium collected from different parties is accummulated as a fund with the insurers. The fund is invested in different business activities and loans so as to earn interest or dividend. As and when loss is suffered by any insured he gets compensated by the insurer as per the terms of his agreement.

Insurability of risks

Insurance coverage is available only for those risks which are considered 'insurable'. There are two major types of insurance coverage. (i) insurance of persons; and (ii) insurance of property

The former covers the risks of illness, death, accident etc which may lead to loss of earning capacity of the person insured. Insurance of property covers the risks of fire, theft and other unforeseen events. The following conditions must be satisfied before a risk can be insured

(i) The risk to be insured must not be a certainty at the time of insurance For example, a house on fire, or a person on the death-bed cannot be insured.

(ii) The amount of loss must be foreseeable and capable of estimation.

(iii) The risk must be spread over a large number of policy-holders, i.e , a large number of people must be interested in such insurance.

(iv) The insurance premium must be such that an average insured may afford it.

(v) The risk must be so dispersed over a wide geographical area that the happening of a single event in a small region may not draw heavily upon the funds of the insurer.

4.6.1 Principles of Insurance

Insurance is a contract. Therefore, it must have all the elements of a valid contract. In addition, there are certain fundamental principles which are applicable specially in the case of insurance contracts. These are:

(i) Principle of utmost good faith Insurance is a contract *uberrimae fidei*, i e , a contract of utmost good faith. It means that both the parties to contract should be absolutely honest to each other. The insured is bound to disclose all material facts known to him, but unknown to the insurer. Similarly, the insurer is bound to disclose honestly the scope of insurance which he is prepared to grant. If there is non-disclosure or misrepresentation of any material fact the agreement will be invalid.

(ii) Principle of indemnity: A contract of insurance is a contract of indemnity. It means that, in case of loss, the insured shall be compensated, but the amount of compensation shall never be more than the actual loss. The insured must not make any profit out of the contract All policies on property are contracts of indemnity A contract of insurance being a contract of indemnity will not be valid where the insurer promises to pay a 'fixed amount' However, life insurance provides for a fixed amount to be paid on the death of a person or after a specified period The principle of indemnity does not apply in that case

(iii) Principle of insurable interest According to this principle, the insured must have monetary interest in the subject matter of insurance, that is the person will either derive monetary benefit from preservation, of the subject matter or he will suffer monetary loss on the happening of the event insured. In case of insurance of property the insured need not be the owner of the property to have monetary interest Even non-owners may have insurable interest. For example, legal heirs have insurable interest in the ancestral property. Similarly, in the case of life assurance, a creditor has insurable interest in the life of his debtor, or a husband has insurable interest in the life of his wife and vice versa

The point of time when the insured must have insurable interest differs in different types of contracts For example, (a) in life insurance insurable interest must be present at the time of making the contract; (b) in the case of fire insurance, insurable interest must be present both at the time of taking such policy as well as at the time of actual loss, and (c) in marine insurance, the insurable interest must be present at the time of actual loss only.

(iv) Principle of causa proxima: This principle lays down that an insured can recover from the insurer for the loss of the subject matter only if it is caused by the risk insured against. If there is only one cause of loss or damage, there is no difficulty. But sometimes, there are a series of causes. In such cases, the principle of proximate cause of loss is followed. For example, in a marine

insurance case, a ship was destroyed by sea water flowing into the ship through a hole made by rats in a lead pipe. The insurer was held liable as the cargo was proximately destroyed by sea water.

(v) Principle of mitigation of loss: According to this principle, an insured must take all reasonable care to reduce the loss i.e., to maintain it We must act as if the property was not insured. For example, if a house is insured against fire, and there is accidental fire, the owner must take all reasonable steps to keep the loss to the minimum. He is supposed to take all steps which a man of ordinary prudence will take under the circumstances.

(vi) Principle of subrogation The term ' subrogation' means substitution, i e., substitution of the insurer in place of the insured According to this principle, the insurer, after compensating the insured, will have the right to exercise all the powers of the insured. In other words the right of the insured will pass on to the insurer For example, if a property is damaged by fire, the insurer will be entitled to the amounts realised on the sale of materials left afterwards

4.6.2 Types of Insurance

Human beings as well as properties and goods are subject to different types of risks which may be insured Thus, for example, individuals may be insured against the risks of death, illness, accident, injury, unemployment etc Movable goods may be insured against fire, theft, perils of the sea, and so on Buildings, plant and machinery may be insured against fire, riots, etc Ships may be insured against the risks of loss or damage due to storms or enemy attack. However, the more important types of insurance against risks are the following·

1 Life insurance; 2. Fire insurance; and 3 Marine insurance

1. Life insurance: In a contract of life insurance, the insurer undertakes to pay a certain sum of money on the death of the insured or on the expiry of a fixed period, whichever is earlier. The premium for life insurance may be paid by the insured either in lump-sum or in instalments at regular intervals—monthly, quarterly, half-yearly, or yearly.

A contract of life insurance is not a contract of indemnity. As it is not possible to estimate the pecuniary loss resulting from the death of a person a fixed amount is specified in the policy The amount is paid to the insured if he survives till the maturity of the policy or his nominee, if the insured dies before the expiry of the period. Life insurance is thus treated as an 'assurance' for payment of money and it is known as 'life assurance'

In India life insurance business was nationalised in 1956 Since then Life Insurance Corporation (LIC) has been the only organization providing life insurance facility. Different types of life policies are issued by the LIC. The important ones are

(i) Whole life policy whereby the sum assured is payable only on the death of the insured;

(ii) Endowment policy which provides for payment of the insured amount either on the death of the insured or on the expiry of the agreed period,

(iii) Term policy which provides protection during the insured period and does not involve investment element,

(iv) Joint life policy on the joint lives of two or more persons, e g., partners, husband and wife etc , and

(v) Group insurance policy which is taken on the lives of members of a family or the employees of an organisation

Some of the policies are 'with profit', others are 'without profit' The former entitle the policy holders to share the profits of the Life Insurance Corporation Because of this feature, 'with profit' policies have become very popular. Policies, whether with or without profit, may be 'with accident benefit' or 'without accident benefit'

Some extra premium is charged by the LIC for covering the risk of accident.

The holder of a life insurance policy (on his own life) may nominate a person to whom the sum assured may be paid in case of his death The nominee may be made either at the time of taking the policy or at any time before the policy matures for payment.

2. Fire insurance: In a contract of fire insurance the insurer undertakes to bear the loss which may be suffered by the insured due to damage or destruction of property by fire It is for a fixed period, generally one year The maximum amount payable by the insurer in the event of loss by fire is specified in the policy. If loss is caused during the period of insurance, the insured can recover only the actual amount of loss suffered or the specified amount whichever is lower The insured is not to make any profit out of the transaction.

Suppose, A insures his house against fire. The market value of the house is Rs. 5 lakh, but he insures it for Rs 2 lakh only. He pays an insurance premium of Rs 200 for one year, say 1988 (1 1.1988 to 31.12.1988). There are three possibilities— (i) no loss is caused by fire during 1988; (ii) loss caused by fire is more than Rs 2 lakh, say Rs.3 lakh; or (iii) only a small part of the house is damaged by fire and the loss is estimated to be just Rs 7,000 The liability of the insurer in these three situations will be as follows

(i) when no loss is caused during 1988, nothing is payable by the insurer;

(ii) when loss amounts to Rs 3 lakh, the insurer's liability is limited to Rs.2 lakh, being the insured value; and

(iii) when loss amounts to Rs.7,000, insurer's liability is limited to Rs.7,000 only, being the actual amount of loss

A person is free to take more than one policy with different insurers in respect of the same subject-matter (property) In that case all the insurers are jointly liable to bear the loss, if any. But the total amount payable cannot be more than the actual loss.

There are various types of fire insurance policies. Important among them are the following:

(i) *Specific policy* in which the liability of the insurer is limited to a specified amount which is less than the value of the property insured,

(ii) *Valued policy* in which the insurer agrees to pay a fixed amount in the event of loss irrespective of the actual loss suffered;

(iii) *Floating policy* which is normally taken by firms to insure goods in store at different places and the quantity and value of which vary from time to time;

(iv) *Replacement policy* which gives an option to the insurer to pay the loss in cash or replaces the property;

(v) *Loss of profit policy* which protects the insured against loss of profit due to dislocation of business because of fire, i.e., the insurer agrees to pay the expected amount of profit; and

(vi) *Comprehensive policy* which provides a cover against risks of loss due to various causes, including fire, such as, lightning, explosion of gas in domestic appliances; bursting and overflowing of water tanks or pipes; riot, strike, earthquake, flood, storm, burglary, etc.

A policy covering comprehensive risks is normally taken by people in connection with their houses and household items. At present, 'householder's policy' is popular Besides, the risks of fire and theft it also covers the risks of bodily injury by accident to the insured or a member of his family if he is also insured.

3. Marine insurance: In a contract of marine insurance, the insurer undertakes to cover the risks of losses on the sea (marine losses) due to perils of the sea Such perils include fire, war, robbery, theft, capture or seizures by enemy ships, etc. They do not include the risks of loss due

to the normal action of the winds or waves.

Marine insurance may be in respect of ship, cargo, freight, or any other subject connected with a marine voyage. For example, a ship-owner may take policy as protection against the risk of damage to the ship; the cargo owner may desire to cover the risk of loss of his cargo in course of the voyage; and a transport company may take insurance for recovery of its freight The whole ship, including cargo etc , may also be insured.

The document containing the contract of marine insurance is called *marine policy* or *sea policy*. The insurer is known as 'the Underwriter'. Marine insurance is generally based on value agreed to in advance. It may be more or less than the estimated loss.

For example, a cargo owner may take a marine policy in respect of his cargo insuring it for Rs.1 lakh though its actual value is Rs 80,000. If the ship sinks during the voyage and the entire cargo is lost, the insurer would be liable to pay Rs.1 lakh, i.e., the insured value agreed to in advance.

Marine policies are of various types They include:

(i) *Voyage policy* which covers a particular voyage,

(ii) *Time policy* which covers a specified period of time;

(iii) *Voyage-cum-time policy* which covers both voyage and a time period;

(iv) *Valued policy* which mentions the value of the subject matter of insurance;

(v) *Unvalued policy* which does not specify the value of the subject matter insured; and

(vi) *Floating policy* which describes the insurance in general terms and leaves the name of the ship and other particulars to be defined by subsequent declaration. The declaration is made by endorsement on the policy or in any other customary manner.

4.7 MISCELLANEOUS SERVICES

(i) Warehousing, (ii) Packaging, (iii) Advertising and Sales Promotion

4.7.1 Warehousing

Goods are produced in firms and factories—big or small These are meant for consumption all over the country They have to be stored for some time before transportation to various places. Even after reaching a wholesaler, it may take some time before they are sold to retailers. Again, storage is required. Indeed storage facilities are required for all types of goods, particularly those which are perishable by nature, such as foodgrains, and those which are likely to be damaged or spoilt if exposed to the sun or rain such as cement, electrical goods, paper, etc.

Warehousing refers to the function of preserving goods from the time they are produced to the time they are consumed. Thus, it creates 'time utility' by storing goods after production for supply in the markets as and when required. In addition, several other functions are performed by warehouse keepers when the goods are in store. They are explained below·

Functions of warehousing

(i) Storage Warehouses provide scientific storage facilities to agriculturists, manufacturers, wholesalers, importers and exporters. Thereby goods are protected from spoilage or damage These facilities are provided at reasonable cost.

(ii) Risk bearing: Once goods are taken over for storage in a warehouse, it becomes the responsibility of the warehouse keeper to ensure their safety The risks of loss or damage are transferred from the owner to the warehouse keeper.

(iii) Price stabilisation When there is excess supply goods can be preserved in warehouses to be released as and when market demand rises. Warehousing thus provides a facility whereby owners and suppliers are relieved of the pressure

to dispose of the goods when their demand is less. It helps in preventing undue fall in prices Similarly, goods can be released from warehouses in times of scarcity to check rise in prices.

(iv) Facilitates payment of duties: Imported goods may be kept at warehouses without payment of customs duties. The delivery of these goods may be taken in instalments. Thus, the duties may also be paid in instalments. This facility reduces the financial burden of the users.

(v) Facilitates marketing: Warehouses permit certain facilities like sorting, grading, packaging, etc , inside their premises. This helps the owners of goods in numerous ways. They may even visit the warehouses with their customers for inspection of goods

(vi) Facilitates financing. Warehouse-keepers may advance money to the owners of goods on the security of their goods The deposit receipts issued by them may also be used as security to borrow money from banks and other financiers.

Types of warehouses

Warehouses may be broadly divided into three categories: (i) private warehouses; (ii) public warehouses; and (iii) bonded warehouses These are explained below·

(i) Private warehouses: Private warehouses are owned by big business firms or wholesalers. They are generally used for storing their own raw materials and finished products The responsibility of their maintenance and insurance is of the owners. Because of huge costs of construction and maintenance, private warehouses are not large in number. Some of the private warehouses are hired by government organisations like the Food Corporation of India.

(ii) Public warehouses: Public warehouses may be owned by anybody who is interested in providing storage facilities for rent or charges. They can be established only on the basis of licences granted by the government and have to follow the instructions of government with regard to methods of operation and rates charged.

Public warehouses provide numerous facilities to all without discrimination. They constitute a vital link in the process of distribution of goods They are often located at convenient places near sea ports, railway terminals and on highways They are especially useful for importers and small manufacturers who can not afford to have their own private warehouses The receipts issued by warehouse keepers can be used as security for loan.

(iii) Bonded warehouses Bonded warehouses are used by importers of goods for keeping their goods in safe custody at or near the ports These are public warehouses licenced by government to accept imported goods before payment of customs duty. They are helpful to importers who find it difficult to pay the duties and get their goods released immediately. Before the payment of duty, goods are kept 'in bond'. They are released only after payment of duty The duty can be paid in instalments which is of great advantage to the importers Bonded warehouses also permit inspection, branding, blending, packaging, etc., in their premises. These warehouses may be owned by government or private owners. In the latter case, they have to operate under the control of the government.

In addition to the above categories, there are, certain warehouses known as government warehouses. These warehouses are owned and maintained by the Central or State Governments, or government corporations like Food Corporation of India. They are used by government as well as by private parties. Most of these warehouses are used either for storing imported goods or agricultural products.

4.7.2 Packaging

Most of us are familiar with the term ' packing'. Goods are to be packed to protect them from

spoilage, leakage, breakage and wastage Packing is necessary during transportation and storage. Different types of packing materials are used for packing different goods. Much depends upon their availability and cost. For example, jute-bags are used for packing foodgrains, tins for edible oils and wooden boxes for fruits

'Packaging' is different from packing. It is concerned with putting articles on the market in convenient lots so that buyers can handle them with ease. For example, biscuits are packaged in small hardpaper or tin containers of 200 gms., or 500 gms. each; edible oils in plastic or tin containers of 1 kg., 2 kg., or 5 kg , each, flour in synthetic bags of 5 kg., or 10 kg., each; and so on.

The size of containers and their attractiveness depend upon: (a) the requirements of the market and (b) the cost of goods and their packaging. If in a market, the buyers are rich families, bigger and attractive containers are likely to be in demand. On the other hand, if the market consists of low income consumers, small containers and cheap packaging may be desirable Such consumers will prefer vegetable oils in 1 kg. poly-packs, biscuits in ordinary paper-packs, and so on. Again, in the case of expensive goods, better packaging may be advisable even if it costs more. Low priced goods should be in simple packages so that the overall cost and price may not increase.

Packaging may be required in wholesale trade as well as retail trade. It depends upon the prevailing custom and convenience. In either case, it facilitates the marketing of goods in the following ways:

(i) it protects the goods from damage and loss;
(ii) it facilitates storage of goods;
(iii) it makes branding and advertising convenient;
(iv) the right quantity, weight and quality are assured to the buyers;
(v) containers make the goods more attractive;
(vi) it attracts consumers, as the containers may be used for other purposes; and
(vii) information regarding the use of products can be printed on the package and easily known to customers.

It is desirable that the packaging of items should be reviewed periodically. New and attractive packaging may increase the sale of existing products. Recently, items like washing powder, baby creams and toilet powders, etc. have been put in new and attractive packages

4.7.3 Advertising and Sales Promotion

A characteristic feature of modern times is the mass production of goods and intense competition among producers and traders. Besides, producers are not only to satisfy the existing demand, but also to create demand for new products. This requires people to be informed about the availability of products, their superiority over similar products, and their alternative uses Advertising provides the means of communicating such information to the present and potential buyers of goods.

Advertising is defined as a paid form of nonpersonal presentation of ideas, goods or services by an identified sponsor Its essential features are: (a) nonpersonal forms of communication, i e., communication without personal contact with the existing or prospective buyers; (b) the advertiser has to pay; for the communication, and (c) there is clear sponsorship by a firm, i.e., the name of the advertiser is no secret. Advertising is often carried out by firms as a routine.

Purpose of advertising: The basic purpose of advertising is to increase the sale of existing and new products or services. The intention may be to persuade the existing buyers to purchase more, or the potential buyers to start purchasing. It is done by (a) providing information (b) arousing interest in the product and (c) giving reasons to justify why particular products or services should be preferred. The purposes of advertising may be outlined as follows:

(i) It brings to the notice of existing as well as prospective buyers the features and new uses of existing products
(ii) It provides information about the availability, features and uses of new products.
(iii) It facilitates choice of goods by the buyers on the basis of relative assessment of different alternatives.
(iv) It persuades dealers to stock goods due to the assurance of reasonable demand
(v) It supports personal selling by providing advance information to the buyers about the product.
(vi) It protects the interest of advertisers as against their competitors
(vii) Repeated advertising helps in developing brand preference and brand loyalty.

Media selection: There are different means of communicating the message to be advertised These are known as media of advertising. Broadly speaking, different types of advertising media may be grouped as follows:
(i) Press (newspapers and magazines)
(ii) Radio
(iii) Television
(iv) Outdoor (handbills, posters, bill boards, electric display, neon signs, etc.)
(v) Miscellaneous media (cinema slides, movies, exhibitions and fairs, window display, calendars etc.)

What media should be used by the advertiser depends upon various factors like the nature of goods to be advertised, cost of advertising, effect of different media on the public etc. Thus, for example, goods for mass consumption like textiles, toilet soaps, hair oil, etc are generally suitable for advertising through radio, television, newspapers and magazines. On the other hand, for machinery and equipments the best media may be business magazines and technical journals. Broadly speaking, the following factors influence the selection of media by any advertiser:
(i) the message to be conveyed and the mode of presentation (oral, written, etc.);
(ii) the cost involved;
(iii) the necessity of repetition and change in the design of advertisement, and
(iv) the category of consumers to be reached.

Sales promotion: The main purpose of advertising goods and services is to promote their sales by creating new demand and attracting buyers to the advertised goods in preference to other competing items. Sales promotion refers to all those activities which are aimed at increasing its sales Besides advertising, the tools of sales promotion may include personal selling or salesmanship and other devices like contests, free gifts, fashion show, discount sales, exhibitions, etc.

SUMMARY

Industry and trade — the two main branches of business activities include manufacturing and production of different varieties of goods and services as well as their marketing for consumption and use Service facilities which are of vital importance to both industry and trade may be classified as follows:

(1) Transport (2) Banking (3) Insurance (4) Others (warehousing, packaging, advertising and sales promotion)

1. Transport

Transport refers to the means of physical movement of goods and packages. Several functions are performed by the transport services which are: (i) widening of markets (ii) large scale production (iii) mobility of resources (iv) specialisation (v) price stability (vi) reduction of congestion in cities (vii) social benefits.

The different modes of transport available for the movement of goods and passengers are land transport, water transport and air transport.

Land transport includes roadways, railways and pipelines. Road transport consists largely of motor car, buses and trucks India has a large network of roads. There are national highways, state highways, district and village roads. Ready availability, speed, flexibility and quality of service are some of the advantages of road transport Railway routes are spread over all parts of the country. They are the most important carriers of passengers and goods traffic within the country Large carrying capacity, economy over long distances and suitability for carrying bulky goods are some of the merits of railways

Since roadways and railways may provide complementary services, coordination is essential in their development and operation Road transport should be developed in areas which are not served by railways

Pipelines are generally used for transportation of liquid petroleum products, natural gas or coal gas It requires heavy expenditure for installation and maintenance of pipelines as well as pumping stations

Water transport involves the use of rivers, canals and the sea Boats, ferries, steamers etc are used in inland waterways, that is, rivers and canals Ships are used in sea transport Inland waterways are useful only if they are navigable throughout the year Many of the rivers and canals are not navigable due to inadequacy of water Ocean transport is most useful for trade among countries connected by sea It is carried out by following definite routes which link all the countries

Air transport is relatively a new means of transport. It is advantageous in situations where speed is desired or where surface transport is lacking It is especially useful for the transport of less bulky goods of high value. However, it involves large capital investment and high operating costs

The suitability of any particular mode of transport depends on (i) its services from the user's point of view (ii) profitability from the operator's point of view and (iii) utility from the point of view of society

2. Banking

It helps business firms to overcome the problem of finance by lending money as and when required Banking refers to the business of accepting deposits and lending money A bank may be defined as an institution which is engaged in accepting deposits, making loans and providing other services to its customers and the general public Commercial banks perform the following five functions (i) acceptance of deposits (ii) grant of loans (iii) discounting of bills (iv) acting as agent and (v) offering miscellaneous services

Banks accept deposits on different conditions and accordingly pay interest These deposits may be divided into different categories of accounts (i) fixed deposit account (ii) savings account (iii) recurring deposit account and (iv) current account.

Lending of money is a permanent function of banks. They lend money on the basis of deposits received. Loans and credits are extended in the form of over-drafts, cash credits or loans and advances Banks also discount bills of exchange of their customers

As agents banks render useful services to their customers, such as realising dividends on shares,

buying and selling securities and payment of insurance premium Other miscellaneous services may include safe custody of valuables and documents, issuing travellers cheques etc

There are several other types of banks in India (i) Agricultural banks (ii) Indigenous bankers (iii) Regional rural banks (iv) Exchange banks (v) Central bank (vi) Development banks

3. Insurance

It is defined as an agreement between two parties whereby one of them called insurer, agrees to protect the other known as insured against a loss which may arise on the happening of an event. The document containing the agreement is called 'the policy' The loss suffered by any one insured is spread among a large number of insured who contribute small amounts of premium Insurance coverage is available only for those risks which are considered 'insurable' There are two major types of insurance coverage (i) insurance of person, and (ii) insurance of property.

Fundamental principles which are applicable specially in the case of insurance contracts are (i) Principle of utmost good faith (ii) Principle of indemnity (iii) Principle of insurable interest (iv) Principle of *cause proxima* (v) Principle of mitigation of loss (vi) Principle of subrogation

The important types of insurance against risks are (i) Life insurance (ii) Fire insurance (iii) Marine insurance

In a contract of life insurance, the insurer undertakes to pay a certain sum of money on the death of the insured or on the expiry of a fixed period, whichever is earlier Different types of life policies available are· Whole life policy, Endowment policy, Term policy, Joint life policy and Group insurance policy

In a contract of Fire insurance, the insurer undertakes to bear the loss which may be suffered by the insured due to damage or destruction of property by fire Various types of fire insurance policies are· Specific policy, Valued policy, Floating policy, Replacement policy, Loss of profit policy, Comprehensive policy

In marine insurance, the insurer undertakes to cover the risks of losses on the sea (marine losses) due to perils of the sea Marine insurance may be in respect of ship, cargo, freight or any other subject connected with a marine voyage Various types of marine policies are. Voyage policy, Time policy, Voyage-cum-time-policy, Valued policy, Unvalued policy, Floating policy,

4. Other Services

Warehousing, Packaging, Advertising and Sales Promotion are other miscellaneous services which are essential to industry and trade

Warehousing provides the facilities of preserving goods from the time they are produced to the time they are consumed Other functions performed by warehouse keepers are storage, risk bearing, price stabilisation, facilitating payment of duties, marketing and financing Warehouses may be broadly divided into three categories (i) Private warehouses (ii) Public warehouses and (iii) Bonded warehouses

Packaging is concerned with putting articles on the market in convenient lots so that buyers can handle them with ease. Packing is necessary during transportation and storage. Different types of packing materials are used for packing different goods

Advertising provides the means of communicating information about the existing and new products and services to the present and potential buyers It is defined as a paid from of non person presentation of ideas, goods or services by an identified sponsor. The basic purpose of advertisir is to increase the sale of existing and new products or services There are different means of cor municating the message to be advertised These are known as media of advertising which are Pre

(newspapers and magazines), Radio, Television, Outdoor, Cinema slides, Exhibitions, and Fairs etc

Sales Promotion activities are undertaken for increasing the sales of the products and services These activities include free gifts, fashion show and discount sales etc

QUESTIONS

I OBJECTIVE TYPE

Indicate whether the following statements are true or false.

1 You can open your current account in Reserve Bank of India
2 You can take an endowment policy in Fire Insurance.
3 Bonded warehouse can be owned by the private owners independently
4 An insurance contract without *Insurable interest* will be treated as void
5. Principle of indemnity is not applicable to personal insurance contract
6. A child does not have an insurable interest in the life of his father
7. Overdraft facilities are available to a Saving Bank Account holder
8. "Window display" is an indoor media of advertisement

II. SHORT ANSWER TYPE

1 State the service facilities which are necessary for business activity
2. Briefly state the importance of road transport for Indian business
3 If you have to transport 10 buffaloes for 500 miles, which mode of transport would you use and why?
4. State the considerations which a business firm should take into account for choosing a mode of transport
5. What is banking?
6 List the functions of a commercial bank.
7. State the types of banks in India
8. Name the specialised institutions which have been set up to fill the gaps in banking activity.
9 Define 'insurable interest'
10. When should insurable interest be present in fire insurance and marine insurance?
11. State the purpose of warehousing.
12 Name the agencies which exist in India for creating warehousing facilities
13 State briefly the purpose of a bonded warehouse
14 Give the meaning of advertising
15. What medium will you like to use to advertise tooth powder?

III. ESSAY TYPE

1 Why do we need service facilities in our trade and industry?
2. Discuss the merits and limitations of road transport.
3. Discuss the merits and limitations of rail transport
4. Why do you find the two prominent modes of transport — rail and road — in a competitive

situation?

5. Discuss the role of water and air transport in Indian business
6. What is development banking?
7. How does a businessman insure against risks in his import-export business?
8. Discuss the principles of *uberrimae fidei, causa proxima* and *subrogation* Give suitable examples
9. Distinguish between packing and packaging Why is packaging so important in marketing of goods?
10. How will you choose your medium of advertising? Explain with the help of examples
11. What is sales promotion?

CHAPTER 5

Forms of Business Enterprises

LEARNING OBJECTIVES

After reading this chapter you will be able to:

1. explain the meaning of and distinguish between private, public and joint sector business enterprises;
2. identify the characteristics of the various forms of private sector enterprises;
3. analyse the meaning, features, merits, limitations and other important aspects of sole proprietorship, joint Hindu family business, partnership, co-operative society and company form of organisation.

5.1 INTRODUCTION

You may recall that the term 'business' refers to an economic activity involving regular production or purchase and sale of goods and services with the object of earning profit through the satisfaction of human wants. The activities of production/purchase and sale are performed in different kinds of organisations. For example, we are all quite familiar with organisations such as the small grocery shop, cement factory, textile mill, automobile repair workshop etc. These organisations are called business undertakings or business enterprises. The characteristics of different types of business enterprises are discussed in this chapter.

5.2 MEANING AND TYPES OF BUSINESS UNDERTAKINGS

Meaning A business undertaking is an organisation through which business activities are carried out. Different terms are used to denote the idea of a business undertaking e.g. a business concern, firm, company, mill, factory, plant, shop, etc.

Types of Business Undertakings: Business undertakings may be distinguished on the basis of size, nature of activities and ownership On the basis of size, we can identify small, medium and large business undertakings According to the nature of activity we may distinguish between industrial, trading and service enterprises. On the basis of ownership, we can talk of private, public and joint sector enterprises. Business undertakings on the basis of ownership are discussed hereafter.

1. Private Sector Enterprises: A private sector enterprise, or a private enterprise is one which is owned, managed and controlled by an individual or a group. They alone are responsible for the profits and losses of the enterprise. The business enterprises owned by business houses like Tatas, Birlas, as well as small and big business firms run by individuals are examples of private sector enterprises. Private enterprises may be of different types- sole proprietorship, joint Hindu family firm, partnership, co-operative and company

2. Public sector enterprises: A public sector enterprise, or a public enterprise, is one which is owned, managed and controlled by the Central Government or any State Government or any local authority. In a public enterprise, government contributes the whole or major part of capital Some of the well-known examples of public enterprises are. Railways, Posts and Telegraphs, Life Insurance Corporation (LIC), Industrial Finance Corporation of India (IFCI), Mahanagar Telephone Nigam (MTN), State Trading Corporation (STC), Bharat Heavy Electricals Ltd. (BHEL), Hindustan Machine Tools (HMT), Food Corporation of India (FCI).

3. Joint sector enterprises: This type of enterprise is one which is owned, managed and controlled jointly by the private entrepreneurs and the government. Such enterprises are also called mixed ownership enterprises. This form of undertaking evolved with the government's intention to encourage private entrepreneurs in industrial activity In joint sector enterprises both the parties share in profits and have to bear the losses. The proportion in which the capital should be contributed by the respective parties is decided by mutual consent Management and control may be with the private entrepreneurs or government representatives Some of the well-known examples of joint sector enterprises are: the Gujarat State Fertiliser Company, Cochin Refineries, Praga Tools Corporation, Indian Rare Earths Limited, etc.

5.3 CHARACTERISTICS OF PUBLIC, PRIVATE AND JOINT SECTOR ENTERPRISES

Some of the most important characteristics of public, private and joint sector enterprises are outlined below.

1. Private sector enterprises: Private enterprises are owned by private individuals and rights of management vest in the owners For the efficient management of such enterprises, professional competent people can be employed by the owners. Such people are then accountable to the owners for their performance and business results Private enterprises are mainly guided by the profit objective.

2. Public sector enterprises: In a public enterprise, ownership is with the government—the Central, the State or the Local The rights of management also vest in the government. Since public enterprises are owned and controlled by the government they are accountable to the public through the government Public enterprises are guided both by the profit and other social objectives such as (i) creation of basic and strategic industries (like steel and oil), (ii) achieving self-reliance in technology, (iii) promoting balanced regional development through the growth of economic activity in the backward and remote areas of the country.

3. Joint sector enterprises: In a joint sector enterprise, ownership is with private entrepreneurs and the government. The responsibility of management generally lies with the private entrepreneurs. Such enterprises are organised to encourage private entrepreneurs to participate in industrial development jointly with the government

On the basis of the above description a comparative view of the public, private and joint sector enterprises is presented below:

5.4. FORMS OF PRIVATE SECTOR ENTERPRISES

General Characteristics

Private sector enterprises may be divided into the following categories.

(i) Sole proprietorship;
(ii) Joint Hindu family;
(iii) Partnership;
(iv) Co-operative society;
(v) Company.

Before discussing the various aspects of these forms of private sector enterprises, it should be proper to outline their general characteristics. Some of the most important characteristics of private sector enterprises include the following·

(i) Ownership of financing. The ownership of a private sector enterprise vests in private individuals. Hence they have to contribute necessary capital for the enterprise.

(ii) Management and control The rights of management and control of a private enterprise vest in the private entrepreneurs. They have to take decisions about the various functions and activities to be performed. The owners, however, can employ professional managers for the efficient and effective functioning of the enterprise.

(iii) Accountability. Where professional managers are employed in a private sector enterprise they are responsible to the private owners for their actions and performance.

COMPARATIVE VIEW OF PRIVATE, PUBLIC AND JOINT SECTOR ENTERPRISES

Forms / *Bases*	*Private Sector Enterprise*	*Public Sector Enterprise*	*Joint Sector Enterprise*
1. Ownership	Private individuals	Government,Central / State/Local	Private entrepreneurs and the government
2. Management	Private owners or professional managers	Government	Mainly with private entrepreneurs
3 Accountability	To the owners	To the public	Both the private entrepreneurs and the government
4. Objectives	Profit	Profit and social objectives	Profit and social objectives

(iv) Objectives: The functioning of a private enterprise is mainly guided by the profit objective. Profits of such enterprises are entirely at the disposal of private owners.

5.5 SOLE PROPRIETORSHIP

Meaning: The sole proprietorship is a form of business that is owned, managed and controlled by an individual He has to arrange capital for the business, and he alone is responsible for its management. He is, therefore, entitled to the profits and has to bear the losses, if any In running his business, however, he can take the help of his family members and also make use of the services of others such as a manager and other employees. This type of business organisation is sometimes called single ownership or single proprietorship If the business primarily consists of trade, the organisation is called a sole trading organisation. Small factories and shops are often found to be sole proprietorship organisations.

It is the simplest and most easily formed business organisation. This is because not much legal formality is required to establish it. For instance, to start a factory the permission of the local authorities is sufficient Similarly, to start a restaurant, it is only necessary to get the permission of the local health authorities. Or again, to run a grocery store, the proprietor has only to follow the rules laid down by local administration.

5.5.1 Features of Sole Proprietorship

The important features of a sole-proprietary organisation include the following:

(i) Individual ownership: One person is the owner in a sole-proprietary form of organisation.

(ii) Risk-bearing: The proprietor is the sole beneficiary of profits in this form of organisation. If there is loss, he alone has to bear it. Thus, the risks of business are borne by the proprietor himself.

(iii) Management and control Management and control of this type of organisation is the responsibility of the sole proprietor. He may, however, employ a manager or other people for the purpose

(iv) Minimum government regulations The government does not interfere with the working of the sole proprietorship organisation. However, they have to comply with the general laws and rules laid down by government

(v) Unlimited liability. The sole proprietor has to bear the losses and is responsible for the liabilities of the business. If the business assets are not sufficient to meet the liabilities he may also have to sell his personal property for that purpose.

5.5.2 Merits of Sole Proprietorship

A sole proprietary organisation has the following advantages·

(i) Ease of formation and closure· A sole proprietorship business is easy to form. There is hardly any legal formality involved in setting up this type of organisation. It is not governed by any specific law. It is simply required that the business activity should be lawful and should comply with the rules and regulations laid down by local authorities Also, the business can be closed whenever the proprietor desires.

(ii) Simplicity of operation and flexible management: In sole proprietary organisation, all the decisions relating to business operations are taken by one person which makes functioning of business simple and easy. The sole proprietor can also bring about changes in the size and nature of activity. This gives flexibility to business.

(iii) Sole beneficiary of profits: The sole proprietor is the only person to whom the profits belong. There is a direct relation between effort and reward. This motivates him to work hard and bear the risks of business.

(iv) Benefits of small scale operations The sole proprietorship is generally organised for small scale business. This helps the proprietor's

family members to be employed in business. At the same time such a business is also entitled to certain concessions from the government. For example, small industrial organisations can get electricity and water supply at concessional rates on a priority basis.

5.5.3 Limitations of Sole Proprietorship

A sole proprietor generally suffers from the following limitations:

(i) Limitation of management skills: A sole proprietor may not be able to manage the business efficiently as he is not likely to have necessary skills regarding all aspects of the business. This poses difficulties in the growth of business also.

(ii) Limitation of Capital: The sole proprietor of a business is generally at a disadvantage in raising sufficient capital. His own capital may be limited and his personal assets may also be insufficient for raising loans against their security. This reduces the scope of business growth.

(iii) Unlimited liability: The sole proprietor is personally liable for all business obligations. For payment of business debts, his personal property can also be used if the business assets are insufficient.

(iv) Lack of continuity: A sole proprietary organisation suffers from lack of continuity. If the proprietor is ill this may cause temporary closure of business. And if he dies the business may be permanently closed.

From the above account of the merits and limitations it becomes clear that it is only personal services like repair work, tailoring etc. small factories, retail shops and professional activities which can be set up as sole proprietary organisations. In India, this form of organisation is quite popular and accounts for the largest number of business units.

5.6 JOINT HINDU FAMILY

The Joint Hindu Family business refers to a business which is owned by the members of a joint Hindu family. It is also known as *Hindu Undivided Family Business* It is governed by the Hindu Law. This form of organisation is created by the law of succession. The joint Hindu family form is a form of business organisation in which the family possesses some inherited property The inheritance of property is among the male members. The share of ancestral property is inherited by a member from his father, grandfather and great grandfather. Thus, three successive generations can simultaneously inherit the ancestral property. For purposes of running a joint Hindu family business, only male members are entitled who are regarded as *co-parceners* and the oldest member is known as *Karta*

5.6.1. Features

The important features of Joint Hindu Family business are outlined below:

(i) Membership. The membership of a joint Hindu family business consists of only the male members. The membership is not created by an agreement but is determined by birth The membership is restricted to three successive generations.

(ii) Management. The management of such a business vests in the eldest member of the family, called *Karta*. The *Karta*, however, may associate other members to assist him in the management of business.

(iii) Liability: The liability of the Karta is unlimited i.e. even his personal assets can be used for the payment of business dues The liability of other members is limited to the extent of their share in the property of the family business.

(iv) Right to accounts. Co-parceners are not entitled to inspect the accounts of the business

(v) Dissolution of business. The joint Hindu family business comes to an end when all the members notify that they are not members of the joint Hindu family. It is, however, not affected by the death of a co-parcener. Thus, the duration of a joint Hindu family business is fairly long.

5.7 PARTNERSHIP

Meaning. Partnership is an association of persons who agree to combine their financial resources and managerial abilities to run a business and share profits in an agreed ratio. Since the resources of a sole proprietor to finance, and his capacity to manage, a growing business is limited, he feels the need for a partnership firm. Partnership business, therefore, usually grows out of the need for expansion of business with more capital, better supervision and control, division of work and spreading of risks.

The Indian Partnership Act defines partnership as "Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any one of them acting for all". The persons who have agreed to join in partnership are individually called 'partners' and collectively a 'firm'. A partnership firm can be formed with a minimum of *two* partners and it can have a maximum of *twenty* partners

5.7.1 Features of Partnership

The features of partnership are as follows:

(i) Existence of an agreement: Partnership is formed on the basis of an agreement between two or more persons to carry on business. It does not arise out of the operation of law as in the case of joint Hindu family business. The terms and conditions of partnership are laid down in a document known as *Partnership Deed.*

(ii) Engagement in Business: A partnership can be formed only on the basis of a business activity. Its business may include any trade, industry or profession Thus, a partnership can engage in any occupation—production and/or distribution of goods and services—with a view to earning profits.

(iii) Sharing of profits and losses: In a partnership firm, partners are entitled to share in the profits and are also to bear the losses, if any.

(iv) Agency relationship: The partnership business may be carried on by all or any of the partners acting for all. Thus, each partner is a principal and so can act in his own right. At the same time he can act on behalf of other partners as their agent. Thus, every partner can bind the firm by his acts.

(v) Liability: The liability of partners is unlimited as in the case of sole proprietorship Partners are individually and collectively liable to creditors of the firm. Hence, the creditors have a right to recover their dues from the private property of one or all partners when the assets of the firm are insufficient.

(vi) Ownership and control. Every partner has a right to take part in the management of the business Hence, the rights of ownership and control are jointly held by the partners

(vii) Non-transferability of share No partner can transfer his share in partnership to any other person. He may, however, do so with the consent of all other partners

(viii) Registration: To form a partnership firm, it is not compulsory to register it. However, if the partners so decide, it may be registered with the Registrar of Firms. There are advantages of registration which are discussed later

(ix) Duration: The partnership firm continues at the pleasure of the partners. Legally a partnership comes to an end if any partner dies, retires or becomes insolvent. However, if the remaining partners agree to work together under the original firm's name, the firm will not be dissolved and will continue its business after settling the claim of the outgoing partner.

5.7.2 Formation and Registration

Partnership Deed. Since partnership rests on an agreement among persons, its formation does not involve any special legal problems. Generally, the partnership agreement is reduced to writing and a Partnership Deed is prepared. Partnership Deed lays down the terms and conditions of partnership and the rights, duties and obligations

of partners. The following points are generally covered in the Deed.

(i) The nature of business;
(ii) Name of the firm and the place where its business will be carried on;
(iii) Amount of capital to be contributed by each partner;
(iv) Duties, powers and obligations of all the partners;
(v) Method of preparing accounts and arrangement for audit;
(vi) Whether loans will be accepted from a partner over and above the capital and, if so, at what rate of interest,
(vii) The amount to be allowed as private drawings by each partner and the interest to be charged thereon,
(viii) The ratio in which profits are to be shared,
(ix) Whether a partner can be expelled and, if so, the procedure for the same,
(x) Method for the settlement of disputes;
(xi) Circumstances under which the partnership will stand dissolved, and in case of dissolution, under whose custody the books of accounts will remain

The Deed has to be stamped and each partner should have a copy of it.

5.7.3 Registration of Firm

Registration of a partnership firm is not compulsory. But an unregistered firm suffers from certain disabilities. These disabilities make it virtually compulsory for a firm to get registered. A partnership firm may be registered at any time That is, at the time of formation or at any time during its existence A partnership firm desiring registration applies to the Registrar of Firms in prescribed form alongwith the registration fee The application should state the following

(i) Name of the firm,
(ii) The principal place of business of the firm,
(iii) The name of any other place where the firm is to carry on business,
(iv) Date of admission of the partners in the firm;
(v) Names and permanent addresses of the partners;
(vi) Duration of the firm.

The application shall be signed and verified by each partner. Changes in the above particulars have to be communicated to the Registrar. The certificate of registration is a reliable evidence and a conclusive proof of the existence of the firm

Consequences of non-registration An unregistered firm suffers from the following serious disabilities

(i) A partner of an unregistered firm cannot file a suit against the firm or any other partner for enforcing his rights arising out of the contract;
(ii) An unregistered firm cannot file a suit against any third party for the recovery of claims;
(iii) Such a firm also cannot file a suit against any partner

5.7.4 Types of Partnership

According to the nature of agreement among partners, there can be three types of partnership as follows·

(i) Partnership at-will Such a partnership exists on the will of the partners That is, it can be brought to an end whenever any partner gives notice of his intention to do so

(ii) Particular partnership. A particular partnership is formed for undertaking a particular venture It comes to an end automatically with the completion of the venture.

(iii) Partnership for a fixed duration. Such a partnership is for a fixed period of time say, 2 years, 5 years or any other duration

5.7.5 Types of Partners

The various types of partners found in partnership

firms are as follows:

(i) Active Partners. Partners who take active part in the conduct of day-to-day business of the firm are called active partners. These partners carry on business on behalf of the other partners.

(ii) Sleeping or dormant partners. Sleeping or dormant partners are those who do not take active part in the management of the business. Such partners only contribute capital in the firm and are bound by the activities of other partners However, they share in the profits and losses of the business.

(iii) Others Active and sleeping partners are, as a matter of fact, the full-fledged partners i.e they share in profits and losses of the business and are liable for its dues. However, there are other types of partners also who may be associated with partnership directly or indirectly. They are not full-fledged partners, such partners may include the following:

(a) *Nominal Partners*. Nominal partners are those who do not have interest in the business but lend their name to the firm. They do not make any capital contribution, and are not entitled to take part in management, but are liable, like other partners, to third parties Such partners generally have a pecuniary interest (like a share in the profits) in lending their name to a firm However, in certain cases they may not have any pecuniary interest in doing so. For example, a reputed industrialist may, without any profit motive, lend his name to a firm run by his family members.

(b) *Partner by holding out* If a person by his words or conduct holds out to another that he is a partner, he will be prevented from denying that he is not a partner. The person who thus becomes liable to third parties to pay the debts of the firm is known as a partner by holding out.

Minor admitted into the benefits of partnership

A minor is a person who has not attained the age of 18 years. Since a minor is not capable of entering into a valid agreement, he cannot become partner of a firm. He may, however, be admitted to the benefits of an existing partnership.

It is clear from the preceding discussion that partners can be of three categories: (i) those who share in the profits and losses of the business and assume liability of the business debts (like active partners, dormant partners and nominal partners), (ii) those who share in profits only (like minor partners) and (iii) those who assume liability without sharing in the profits of the business (like partners by holding out).

5.7.6 Merits of Partnership

A partnership form of organisation offers the following advantages:

(i) Ease in formation A partnership is very easy to form. All that is required is an agreement among the partners. Even the expenses to be incurred for registration are not much.

(ii) Pooling of financial resources: A partnership commands more financial resources compared to sole proprietorship This helps in expanding business and earning more profits. As and when a firm requires more money, more partners can be admitted

(iii) Pooling of managerial skills A partnership facilitates pooling of managerial skills of all its partners. This leads to greater efficiency in business operations. For instance, in a big partnership firm, one partner can handle production function, another partner can all look after marketing activity, still another can attend to legal and personnel problems, and so on

(iv) Balanced business decisions. In a partnership firm, decisions are taken unanimously

after considering all the major aspects of a problem. This ensures not only balanced business decisions but also removes difficulties in the smooth implementation of those decisions.

(v) Sharing of risks: Unlike sole proprietary organisation, the risks of partnership business are shared by partners on a predetermined basis. This encourages partners to undertake risky but profitable business activities.

5.7.7 Limitations of Partnership

A partnership form of organisation suffers from the following major limitations.

(i) Uncertainty of existence: The existence of a partnership firm is very uncertain. The retirement, death, bankruptcy or lunacy of any partner can put an end to the partnership. Further, the partnership business can come to a close if any partner demands it.

(ii) Risks of implied authority. It is true that like the sole proprietor each partner has unlimited liability. But his liability may arise not only from his own acts but also from the acts and mistakes of co-partners over whom he has no control. This discourages many persons with money and ability, to join a partnership firm as partner.

(iii) Risks of disharmony: In partnership, since decisions are taken unanimously, it is essential that all partners reconcile their views for the common good of the organisation But there may arise situations when some partners may adopt rigid attitudes and make it impossible to arrive at a commonly agreed decision. Lack of harmony may paralyse the business and cause conflict and mutual bickerings.

(iv) Difficulty in withdrawal from the firm: Investment in a partnership can be easily made but cannot be easily withdrawn. This is so because the withdrawal of a partner's share requires the consent of all other partners.

(v) Lack of institutional confidence. A partnership business does not enjoy much confidence of banks and financial institutions. It is because the nature of its activities is not disclosed to the public and the agreement among partners is not regulated by any law. As a result large financial resources cannot be raised by partnerships and growth of business cannot be ensured.

(vi) Difficulties of expansion: It is difficult for a partnership firm to undertake modernisation of expansion of its operations. This is because of its inability to raise adequate funds for the purpose. Limited membership (restricted to 20) and their limited personal resources do not permit large amounts of capital to be raised by the partners. Therefore, large scale business cannot generally be organised by partnerships.

It is quite obvious from the discussion that the partnership form of organisation is excellent when the size of business is medium, i.e. neither too small not too large, and when the partners can work in full co-operation with one another.

5.8 CO-OPERATIVE ORGANISATION

Meaning: A co-operative form of business organisation is different from other forms of organisation. It is a voluntary association of persons for mutual benefit and its aims are accomplished through self help and collective effort. The main principle underlying a co-operative organisation is mutual help, i.e , each for one and all for each. A minimum of 10 persons are required to form a co-operative society. To be called a co-operative society it must be registered with the Registrar of Co-operative Societies under the Co-operative Societies Act. The capital of a co-operative society is raised from its members by way of share capital. It can also obtain additional resources by way of loans from the State and Central Co-operative Banks.

A Co-operative society has much in common with partnership, yet there are differences between the two types of organisation. In partnership, mutual benefit is restricted to partners only, but in a co-operative society it extends to its members as also the public. For example, in a

consumer co-operative store or a co-operative credit society, the benefits are available to the members as well as the general public Besides, partnership requires the existence of some business activity whereas a co-operative may be formed whenever individuals have common needs which are difficult to fulfil single-handed Also, registration is optional in the case of partnership but it is compulsory for a co-operative society.

5.8.1 Types of Co-operative Societies

Co-operative societies may be classified into different categories according to the nature of activities performed by them The main types of co-operative societies are

1. Consumers' co-operative societies,
2. Producers' co-operative societies,
3. Co-operative marketing societies;
4. Co-operative credit societies,
5. Co-operative farming societies,
6. Co-operative housing societies.

1. Consumers' co-operative societies: Consumers' co-operatives are organised by consumers *to eliminate middlemen and to establish direct relations* with the manufacturers or wholesalers These societies are formed by consumers to ensure a steady supply of goods and services of high quality at reasonable prices. It purchases goods either from the manufacturers or the wholesalers for sale at reasonable prices The profit if any, is distributed among members as dividend in the ratio of capital contributed and also as bonus in proportion to the purchases made by them.

2. Producers' co-operative societies: Producers' co-operative are formed *to help the members in procuring inputs* for production of goods or services. These societies generally provide raw-materials, tools and equipment and other common facilities to its members. This helps them to concentrate their attention on production of goods The society provides inputs to the members and takes over their output for sale to outsiders The basis for distribution of bonus is the goods delivered for sale by each member.

3. Co-operative marketing societies: Co-operative marketing societies are voluntary associations of small producers, who find it difficult to individually sell their products at a profit. The main purpose of such a society is *to ensure a steady and favourable market* for the output of its members. The output is pooled together and sold at the best price The sale proceeds are distributed in proportion to the contribution of the members to the pool Marketing co-operatives eliminate middlemen and ensure honest trading practices in weighing, measuring and accounting.

4. Co-operative credit societies: Such societies are formed *to provide financial help* in the form of loans to members The funds of these societies consist of share capital contributed by the members and the deposits made by them and outsiders. The funds are used in giving loans to needy members on easy terms Thus, the members are protected from the exploitation of money lenders, who charge very high rates of interest Another important purpose of credit co-operatives is *to encourage the habit of thrift* among their members.

5. Co-operative farming societies: In co-operative farming societies, small farmers join together and pool their resources *for cultivating their land collectively* Their object is to achieve economies of large scale farming and maximising agricultural output Such societies are particularly important in the case of countries like India, where agriculture suffers from excessive sub-division and fragmentation of land Co-operative farming makes it possible for members to use modern tools and equipments, good seeds, fertiliser and irrigation facilities in order to achieve higher production

6. Co-operative housing societies: They are formed *to provide residential accommodation* to the members They undertake the purchase and development of land and/or construction of houses/flats on the land Some housing co-operatives provide their members with necessary loans at low rates of interest to build houses. These societies are gaining popularity in big cities.

5.8.2 Characteristics of Co-operative Organisation

The following are the main characteristics of co-operative societies

(i) Voluntary association. In co-operatives, the membership is voluntary Anybody having a common interest is free to join a co-operative society The member can also leave the society anytime after giving proper notice

(ii) Equal voting rights In a co-operative society, the principle of one man one vote is adopted A member has only one vote irrespective of the number of share(s) held by him Thus, a co-operative society is run on democratic principles

(iii) Separate legal entity A co-operative society is required to be registered under the Co-operative Societies Act Registration provides it a separate legal entity. Its existence is quite different from its members The death, insolvency or lunacy of a member does not affect its existence It can sue and be sued in its own name It can make agreements as well as purchase and sell property in its own name.

(iv) Service motive A co-operative society is based on the service motive of its members Its main objective is to provide service to the members and not to maximise profits Earning profit is the most important objective of other forms of business organisation It is not so in the case of co-operatives.

(v) Distribution of surplus Out of the profits of the co-operative, members are paid dividend and bonus. The bonus is given according to the volume of business transacted by each member with the co-operative society. For example, in a consumer co-operative society, bonus is paid in proportion to the purchases made by members during a year. In a producers' co-operative the value of goods delivered for sale form the basis of distributing bonus.

5.8.3 Merits of Co-operative Organisations

The co-operative form of organisation offers the following advantages

(i) Easy to form A co-operative society is a voluntary association and may be formed with a minimum of ten adult members Its registration is very simple and can be done without much legal formalities

(ii) Open membership Membership in a co-operative organisation is open to all having a common interest A person can become a member at any time he likes and can leave the society by returning his shares without affecting its continuity.

(iii) Democratic management. A co-operative society is managed in a democratic manner. It is based on the principle of one man one vote. All members have equal rights and can have a voice in its management

(iv) Limited liability The liability of the members of a co-operative society is limited to the extent of capital contributed by them They do not have to bear personal liability for the debts of the society

(v) Stability A co-operative society has a separate legal existence It is not affected by the death, insolvency, lunacy or permanent incapacity of any of its members. It has a fairly stable life and continues to exist for a long period

(vi) Economical operations. The operation of a co-operative society is quite economical due to elimination of middlemen and the voluntary services provided by its members.

(vii) Government patronage. Government gives all kind of help to co-operatives, such as loans at lower rates of interest and relief in

taxation.

(vii) Other benefits Certain non-economic benefits are also derived by members through co-operatives. Credit co-operatives, for instance, promote habits of thrift and producers' co-operative encourage joint activity among members.

5.8.4 Limitations of Co-operative Organisations

As against the above-mentioned advantages of co-operatives the following limitations and drawbacks of this form of organisation must also be noted

(i) Limited capital Co-operatives are usually at a disadvantage in raising capital because of the low rate of return on capital invested by members.

(ii) Inefficient management The management of a co-operative society is generally inefficient because the managing committee consists of part-time and inexperienced people. Qualified managers are not attracted towards a co-operative on account of its limited capacity to pay adequate remuneration

(iii) Absence of motivation A co-operative society is formed for mutual benefit and the interest of individual members are not fully satisfied. There is no direct link between effort and reward. Hence members are not inclined to put in their best efforts in a co-operative society.

(iv) Differences and factionalism among members Once the initial enthusiasm about the co-operative ideal is exhausted, differences and group conflicts arise among members. Then it becomes very difficult to get full co-operation of the members. The selfish motives of members begin to dominate and service motive is sometimes forgotten But the society continues because it functions in the interest of members.

(v) Rigid rules and regulations · Excessive government regulation and control over co-operatives affect their functioning. For example, a co-operative society is required to get its accounts audited by the auditors of the co-operative department and to submit its accounts regularly to the Registrar. These regulations and control may adversely affect the flexibility of operations and the efficiency of management in a co-operative society.

5.9 COMPANY

The company form of organisation is considered to be most suitable for organising business activities on a large scale as it does not suffer from the limitations of capital and management of other forms of organisation. The sole proprietorship, partnership and co-operative organisations are not capable of undertaking large scale activity due to lack of adequate capital and limited managerial abilities In a company organisation those problems can be easily overcome. It has the advantage of attracting huge capital from the public due to the limited liability of members. With adequate capital it can also employ trained and experienced managers to run the business activities efficiently

Meaning A company is defined as a voluntary association of persons having separate legal existence, perpetual succession and a common seal. As per the definition, there must be a group of persons who voluntarily agree to form a company. Once formed the company becomes a separate legal entity with a distinct name of its own. Its existence is not affected by change of members. It must have a seal to be imprinted on documents whenever required The capital of a company consists of transferable shares, and members have limited liability.

5.9.1 Features of a Company

The following are the chief characteristics of the company form of organisation.

(i) Registered body · A company comes into existence only after its registration. For that purpose, necessary legal formalities have to be

completed as prescribed under the Companies Act.

(ii) Distinct legal entity A company is regarded as a legal entity separate from its members. Thus, a company can carry on business in its own name, enter into contracts, sue, and be sued.

(iii) Artificial person A company is the creation of law and has a distinct entity. It is therefore, regarded as an artificial person The business is run in the name of the company. But because it is an artificial person, its functions are performed by the elected representatives of members, known as directors.

(iv) Perpetual succession A company has continuous existence independent of its members. Death, insolvency, or change of members has no effect on the life of a company The common saying in this regard is that 'members may come, members may go, but the company goes on for ever'. The life of the company can come to an end only through the prescribed legal procedure.

(v) Common seal Since a company is an artificial person, it has no physical existence The activities of the company are carried through a group of natural persons elected by its members (called directors) Every company must therefore, have a common seal with its name engraved on it Anyone acting on behalf of the company must use the common seal to bind the company.

(vi) Limited liability The liability of the members of a company is limited It is limited to the extent of 'capital agreed to be contributed'. Beyond that amount, the members cannot be personally held liable for payment of the company's debts

(vii) Transferability of shares: The capital of a company is divided into parts called shares Normally the shares of a company are freely transferable by its members. However, transferability is restricted in the case of private company.

5.9.2 Merits of Company

The most important advantages of a company organisation may be stated as follows:

(i) Collection of huge financial resources The biggest advantage of a company organisation is that it has the ability to collect large amounts of funds This is because a company can raise capital by issuing shares to a large number of persons Shares of small value can be subscribed even by people with small savings In addition, company can also raise loans from the public as well as different lending institutions. Availability of necessary funds makes it possible for a company to undertake business activities on a large scale

(ii) Limited liability· Another advantage of the company form of organisation, is the limited liability of members. With the liability of members limited to the value of their shares, a company is able to attract many people to invest in its shares. It is thus in a position to undertake business ventures involving risks

(iii) Free transferability of shares A company permits its members to transfer their shares, Free transferability of shares provides liquidity to the members investment. Thus, if a member needs cash he can sell his shares Or, he can use the same amount to buy shares of another more profitable company. It enables profitable companies also to attract funds away from the less profitable ones.

(iv) Durability and stability· A company is the only form of organisation which enjoys continuous existence and stability. The funds invested in a company by shareholders are not withdrawable until it is wound up Also, any change in the company's membership does not affect its life. As a result of this, a company can undertake projects of long duration and attract people to invest in the business of the company.

(v) Growth and expansion With the large resources at its command a company can organise

business on a large scale. Once the business is started on a large scale it gives the company strength to grow and expand. This is because of high profits which accrue from the economies of large scale organisation and production

(vi) Efficient management: Since a company undertakes large scale activities, it requires the services of expert professional managers Competent managers can be easily hired by a company because it commands large financial resources Thus, efficient management is ensured in a company organisation.

(vii) Public confidence A company enjoys great confidence and trust of the general people Companies have to disclose the results of their activities and financial position in the annual reports These reports are available to the public. It is on the basis of the annual reports and other information that investment is made in companies

(viii) Social benefits Apart from the benefits mentioned above a company organisation also offers the following social benefits:

(a) Democratisation of management In the company form of organisation, management of business is entrusted to the elected representatives of shareholders, that is the directors. As a result of democratic management the business of a company is run in the best interest of the majority of shareholders.

(b) Dispersal of ownership Since a large number of persons are associated with a company as members, its ownership is widely held Thus the benefits of the company's operations are distributed among a large section of people

(c) Assumption of social responsibilities. Large companies often undertake and contribute to social welfare activities by making donations to schools and colleges, developing rural areas, running health-care institutions, and so on.

5.9.3 Limitations of Company Organisation

A company organisation suffers from the following limitations

(i) Lengthy and expensive legal procedure The registration of a company is a long drawn process A number of documents are to be prepared and filed For preparing documents, experts are to be hired who charge heavy fees Besides, registration fees have also to be paid to the Registrar of Companies.

(ii) Excessive government regulations A company is subject to government regulations at every stage of its working A company has to file regular returns and statements of its activities with the Registrar There is a penalty for non-compliance of the legal requirements. Filing returns and reports involving considerable time and money is the responsibility of the company All this reduces flexibility in operations

(iii) Lack of incentive The company is not managed by shareholders but by directors and other paid officials Officials do not have investment in the company and also do not bear the risks. As such, they may not be as much motivated to safeguard the interests of the company as the shareholders

(iv) Delay in decision-making and action In large companies, decision making and its implementation happen to be a time consuming process This is obviously because individual managers are unable to take decisions on their own. They may have to consult others which may take a lot of time Similarly, after decisions are taken, they have to be communicated to people working at various levels of the organisation It also delays the implementation of already delayed decisions

(v) Conflict of interest A company is generally characterised by a large organisation with many groups operating in it. So long as the interests of these groups do not clash with each other they work for the good of the organisation. But sometimes, individual and group interests become difficult to reconcile For instance, the sales manager may be interested in the quality of products to satisfy customers and increase sales, but the production manager may be more concerned

with maximum production without regard to the product quality In such a situation, the business is bound to suffer in course of time unless there is a reconciliation of the conflicting view points of the two managers

(vi) Oligarchic management The company management may seem to be fully democratic, but in actual practice, it is the worst form of oligarchy i e control by a small group of persons People who are once elected as directors of a company adopt various means to get themselves re-elected over and again. Such individuals often exploit the company for personal interests instead of working in the interest of shareholders

(vii) Speculation In speculation, profit is sought to be made by manipulating prices of shares without actually holding shares A company organisation provides scope for speculation in shares by the directors Because directors have knowledge of all information about the functioning of the company, they can use it to their personal advantage For example, directors may sell or buy shares knowing that prices will decline or go up because of low or high profits. As a result of this, innocent shareholders may suffer loss

(viii) Growth of monopolistic tendencies A company because of its large size has the tendency to grow into a monopoly so as to eliminate competition, control the market and charge unreasonable prices to maximise profits. Larger the size of a company greater is the possibility of it acquiring monopoly power Companies like Colgate-Palmolive have a near monopoly position in tooth paste, and Parle in soft drinks.

(ix) Influencing government decisions Big companies are generally in a position to influence government officials to make decisions in their favour This is because such companies have large financial resources and are in a position to bribe even high officials.

From the preceding discussion it is clear that the company form of organisation is best suited to those lines of business activity which are to be organised on a large scale, require heavy investment of capital with limited liability of members That is why enterprises producing steel, automobiles, computers and other high technology products are generally organised as companies

5.10 CHOICE OF FORM OF ORGANISATION

Having discussed the characteristics, merits and limitations of the various forms of organisation (sole proprietorship, joint Hindu family business, partnership, co-operative and company organisation) we may consider how to select the most suitable form of organisation for a business venture Choice of a suitable form of organisation is important because the success and growth of a business depends a great deal on it The form of organisation determines the availability of finance, risk associated with business, division of profit, owners' control, stability and durability of business, and so on Since business and entrepreneurial objectives vary, no single form of organisation can be considered as the best for all kinds of business The selection of a suitable form of organisation is generally made after careful consideration of the following factors

(i) Nature of business — manufacturing, trading, service,
(ii) Scale of operations—volume of business (small, medium, large) and the market area served (local, national, international),
(iii) Financial requirements for starting and expanding business;
(iv) Degree of direct control desired by the owners;
(v) Degree of risk and liability;
(vi) Division of profit;
(vii) Flexibility of operations;
(viii) Stability of business;
(ix) Legal procedure

It needs to be emphasised that these factors are inter-related and influence each other For instance, the financial requirements of a business

depend upon the nature of business as well as the scale of operations The establishment of an industrial enterprise (production of toys, for example) on a large scale would need greater outlay of capital, than a small enterprise for the same purpose Similarly, the degree of risk and liability will depend both on the amount invested and the nature of demand for the products of the enterprise Thus, for a small enterprise (say, a workshop or a grocery shop) the risk will be limited and so will be the owner's liability, even if his personal assets may be used to discharge business debts. Control and sharing of profit are interconnected and both are related to the risk and liability If the risk and liability are not heavy, the entrepreneur would not like to give up control and share profits with others

SUMMARY

1. Meaning and Types of Business Undertakings

A business undertaking is an organisation through which business activities are carried out Business undertaking can be of three types private, public and joint sector enterprises

A private enterprise is owned, managed and controlled by an individual or a group Owners are responsible for the profits and losses of the enterprise

A public sector enterprise is owned, managed and controlled by the Central, State or any local authority.

A joint sector enterprise is owned, managed and controlled jointly by the private entrepreneurs and the Government

These enterprises can be differentiated from each other on the basis of ownership, management, accountability and objectives Different types of private enterprises are, namely, sole proprietorship, joint Hindu family business, partnership, co-operative society and company

2. Sole Proprietorship

The sole proprietorship is a form of business that is owned, managed and controlled by an individual. The sole proprietor alone is entitled to the profits and has to bear the losses In other words, his liability is unlimited. This form of organisation has the advantages of ease of formation and closure, simplicity of operation and flexibility of management, undivided claim on profits and the benefits of small scale operations. However, it suffers from the limitations of management skills, capital, unlimited liability and continued existence

3. Joint Hindu Family

The joint Hindu family business represents a business organisation owned by the members of a Joint Hindu Family. It is governed by the Hindu Law. Only male members, restricted to three successive generations can become its members. Thus, membership is not created by an agreement but is determined by birth The oldest member is called *Karta* and is responsible for managing the business Except for him, the liability of other members is limited.

4. Partnership

The partnership form of organisation is an association of persons who pool their financial resources and managerial abilities to share the profits of a business in an agreed ratio Unlike joint Hindu family

business, the partnership organisation is formed on the basis of an agreement between a minimum of 2 persons to carry on a business. A maximum of 20 persons can be members in partnership. In a partnership organisation, each partner is a principal and the agent of other partners and can bind the firm by his acts. The liability of partners is unlimited. Registration of a partnership firm is not compulsory. But when so desired it may be registered with the Registrar of Firms under the Indian Partnership Act.

Various types of partners are found in partnership firms: active and sleeping partners (full-fledged partners), nominal and holding out partners. A minor can also be admitted into the benefits of partnership. These partners may be found in all the three types of partnership namely, partnership at will, particular partnership and partnership for a fixed duration.

A partnership organisation offers various advantages, like ease of formation, pooling of financial and managerial resources, balanced business decisions and sharing of risks. However, it suffers from limitations, like uncertainty of existence, risks of implied authority, risk of disharmony, difficulty in withdrawal from the firm, lack of institutional confidence and difficulties of expansion and modernisation.

5. Co-operative

A co-operative form of organisation is established by a group of persons who voluntarily come together for mutual benefit. The aims of a co-operative society are accomplished through self-help and collective effort. The principle of one-man-one-vote governs the functioning of a co-operative. The capital of a co-operative society is raised by issue of shares to the members, and as loans from the State and Central Co-operative Banks. Out of the profits, the members are paid dividend and bonus according to the business transacted by them with the co-operative society. Unlike sole proprietorship and partnership, a co-operative organisation has a separate legal entity. It can be registered with the Registrar of Co-operative Societies.

The main types of co-operative societies are, consumers' co-operatives, producers' co-operatives, co-operative credit societies, marketing co-operatives, co-operative farming societies, and co-operative housing societies.

A co-operative organisation has advantages, like easy to form, open membership, democratic management, limited liability, government patronage, and other non-economic benefits. A co-operative organisation has also certain limitations, like limited capital, inefficient management, absence of motivation, differences among members, rigid government rules and regulations.

6. Company

A company form of organisation may be defined as an artificial person created by law, having an independent legal entity, with a perpetual succession, a common seal and the capital fund consisting of transferable shares, with limited liability. These features of a company organisation permit it to conduct business on a large scale and also overcome the limitations of capital and management of sole proprietorship, partnership and co-operatives. In spite of these features and advantages, a company organisation has several limitations such as lengthy and expensive legal procedure, excessive government regulations, lack of incentive of managers, delay in decision making and action, conflict of interest, oligarchic management, speculation, growth of monopolistic tendencies and influencing government decision for narrow interests.

The main purpose of discussing the features, merits and limitations of the various forms of private enterprises is to select a form of organisation that can effectively meet the business and

entrepreneurial objectives Since business and entrepreneurial objectives vary, no single form of organisation can be considered as the best for all kinds of business However, the selection of a suitable form of organisation can be made after carefully considering these factors nature of business, scale of operations, financial requirements, degree of direct control desired by owners, degree of risk and liability, division of profit, flexibility of operations, stability of business, legal procedure Because these factors are inter connected, their collective effect should govern the final choice

QUESTIONS

I. OBJECTIVE TYPE

Indicate whether the following statements are true or false:

1. Sole proprietorship involves a lengthy and expensive procedure for its formation
2. Liability of a sole proprietor is limited to the extent of his share in business
3. Except for *Karta*, the liability of all other members is limited in a joint Hindu family business
4. Females cannot become members in a joint Hindu family business
5. Registration of a partnership firm is compulsory.
6. Maximum number of partners in a partnership firm is twenty
7. Liability of partners in a partnership firm is unlimited
8. An active partner does not contribute capital in a partnership firm
9. An unregistered firm cannot be sued by a third party
10. 'One man one-vote' principle is adopted in a co operative society.
11. Registration of a co-operative society is optional
12. Minimum number of members required to form a co-operative society is two
13. Company is an artificial person.
14. Shares of a company are generally freely transferable
15. Liability of a shareholder is unlimited
16. Death, insolvency or lunacy of a shareholder brings a company to an end.

II SHORT ANSWER TYPE

1. Define business enterprise. Enumerate the various types of business enterprises
2. Define private business enterprise Explain its characteristics
3. Define public enterprise. Name five public enterprises operating in India
4. What is a joint sector enterprise? Name three public joint sector enterprises in India.
5. Distinguish between private, public and joint sector enterprises
6. Define partnership State its important features
7. Outline the procedure for registration of partnership
8. Enumerate the various types of co operative societies.

III ESSAY TYPE

1. What do you understand by sole proprietorship? Outline its features Explain its merits and limitations.
2. "One man control is best in the world if that one man is big enough to manage everything". Explain the statement

3. Explain the features of a joint Hindu family business
4. Discuss the merits and limitations of partnership
5. Describe the various kinds of partners in a partnership firm and discuss their rights and obligations
6. Define partnership deed Discuss its main contents
7. Define co-operative organisation. Explain its main characteristics
8. Discuss the advantages and limitations of co-operative organisation Name activities which can be suitably undertaken by co-operative societies
9. What is a company? What are its characteristics? Explain its advantages and limitations.
10. Differentiate between company and co-operative organisation
11. List the factors that help in choosing a suitable form of organisation

CHAPTER 6

Corporate Organisation

LEARNING OBJECTIVES

After reading this chapter, you should be able to.

1. identify the features of private, public and government companies;
2. gain an elementary idea of multinational companies;
3. appreciate the concept and rationale of public sector;
4. classify the forms of organising public sector enterprises.

6.1 INTRODUCTION

In the preceding chapter, we have discussed the various forms of organisation of business enterprises, their advantages and limitations. The discussion made it clear that business in our country can be run by private individuals as well as the government. Private individuals can adopt various forms of organisation for the business — sole proprietorship, joint Hindu family firm, partnership, co-operative society or a company. Similarly, the Government may conduct business activities through departmental undertakings, statutory corporations, and government companies. In this chapter we shall discuss the various forms of company organisation and the forms of public sector enterprises.

6.2 TYPES OF COMPANIES

The company form of business organisation is very popular in the world today. Companies may be classified as private, public and government companies.

Private Company

A private company is one which:

(i) has a minimum of 2 and a maximum of 50 members, excluding past and present employees,

(ii) does not invite the public to subscribe to its capital;

(iii) restricts the right of members to transfer their shares.

All these three restrictions must be continuously observed by a company to be called a private company. Such a company can manage its affairs with a minimum of 2 Directors only. It must include the word 'private limited' as a part of its name. Nirma Chemical Works Pvt. Ltd. is an example of a private company.

A private company is an ideal form of organisation for those who wish to run a business without associating a large number of members and at the same time deriving the benefit of limited liability. This form of organisation enables a small group of persons to control the management of the company without the risk of displacement by any large shareholding group.

Public Company

A public company form of organisation is one which:

(i) has a minimum of 7 members;

(ii) is not prohibited from inviting the general public to subscribe to its shares and debentures, and

(iii) does not restrict the right of its members to transfer their shares freely.

In a public company, the maximum number of members depends upon the number of shares issued. A public company can manage its affairs with a minimum of 3 Directors. Since the liability of members is limited, these companies must add the word 'limited' or its abbreviation 'Ltd.' to their name. Food Specialities Ltd., Bata India Ltd., MRF Tyres Ltd., Tata Oil Mills Company Ltd. are examples of public companies.

A public company is an ideal form of organisation for starting business on a large scale. This is because members of the general public can be invited to subscribe to its capital. Large enterprises producing steel, automobiles, computers and other high technology products are organised as public company.

Government Company

A government company is one which is started by government and of which majority of capital is subscribed by the Central and/or State Government(s). Some of the well-known government companies are: Bharat Heavy Electricals Limited (BHEL), Hindustan Machine Tools Limited (HMT), Indian Oil Corporation (IOC), Maruti Udyog Limited.

6.3 MULTINATIONAL COMPANIES

A multinational company (MNC) is an organisation that

(i) operates in more than one country;

(ii) carries out production, marketing and research activities in those countries, and

(iii) attempts to maximise profits world-over

A multinational company is of a giant size. Some of the well-known multinational companies are General Motors (USA), Coca Cola (USA), Pepsi Cola (USA), Ponds (USA), Brook Bond (UK), Lipton (UK), Sony (Japan), Suzuki (Japan) Some of the top business houses of India like Tatas Birlas also own multinational companies The Indian multinational companies are much smaller in size in comparison with multinationals of advanced countries.

6.4 PRIVILEGES OF A PRIVATE COMPANY

A private company is entitled to certain privileges which are given below

(i) Number of members A private company can be formed with only 2 members, whereas at least 7 members are required to form a public company. This makes its formation easier.

(ii) Number of directors A private company need to have only 2 Directors while a public company must have 3 Directors.

(iii) Index of members A private company need not keep an index of its members which is absolutely necessary for a public company.

(iv) Loans to directors. A private company is not required to take permission from the government while giving loans to Directors. as is required in case of a public company

(v) Legal formalities A private company is exempt from certain legal formalities like issue of prospectus, getting certificate of commencement of business, minimum subscription, quorum, etc which are necessary in case of a public company. Details of these formalities are given later.

DISTINCTION BETWEEN PRIVATE COMPANY AND PUBLIC COMPANY

	Factors	*Private Company*	*Public Company*
1	Number of members	Minimum 2 Maximum 50 (excluding past and present employees)	Minimum 7 Maximum depends upon the number of shares issued
2	Invitation for public subscription	No public offer of shares or debentures	Invitation to public allowed
3	Transfer of shares	Transfer of shares restricted	Free transfer of shares allowed
4	Number of Directors	Minimum 2	Minimum 3
5	Index of members	Not compulsory	Absolutely necessary
6	Legal formalities	Exempt from legal formalities regarding prospectus, certificate of commencement of business, quorum, etc	Not exempt from legal formalities

6.5 PUBLIC ENTERPRISES

Ours is a mixed economy where both the government and the private sector have set up business enterprises. Before independence the Indian economy was largely a private sector economy. The 'private sector' refers to economic and social activities performed under individual or group ownership. The 'public sector' on the other hand refers to economic and social activities undertaken by public authorities (Central and State Governments, Municipalities, etc).

The objectives of setting up business enterprises in the public sector may be briefly stated as follows:

(i) to bring about rapid industrial development by setting up large industries which require huge capital investment and may not be profitable in the short-run,

(ii) to develop those industries which facilitate the growth of other industries like, for example, transport, power generation; etc

(iii) to correct regional imbalance in the growth of industries;

(iv) to check the growth of monopoly and monopolistic tendencies in the private sector;

(v) to ensure adequate supply of essential goods at a fair price.

Organisations set up in the public sector are known as public enterprises. Such enterprises are owned, managed and controlled by the government or local authorities. They are also known as 'public undertakings' or 'public sector undertakings'. Examples of public enterprises are Indian Railways, Life Insurance Corporation of India, Indian Airlines, State Trading Corporation, Hindustan Antibiotics Ltd.

6.5.1 Features

The main features of a public enterprise are.

(i) State ownership. A public enterprise is ned by the Central Government or a State Government, or jointly by both. A major part of its capital is owned by the government.

(ii) State control. The control over the management of a public enterprise rests with the government, which appoints the majority of directors and other top officials.

(iii) State financing. The primary source of financing a public enterprise is the government. The funds are made available either from the government treasury or budget of the concerned Ministry-department, or investment by the government in the share capital of the enterprise.

(iv) Socio-economic objectives. Public enterprises are essentially guided by the objective of deriving social and economic benefits for the community as a whole like rapid industrialisation, creation of employment, balanced regional development etc.

(v) Public accountability. The performance of a public enterprise is subject to scrutiny of the Parliament or State Legislature. The Committee on Public Undertakings or Estimates Committee or Public Accounts Committee evaluates the working of the public enterprises. Their reports highlight the shortcomings of the public enterprises and are presented for discussion in Parliament or State assembly.

6.5.2 Rationale: Why Public Sector and Public Enterprise

The main consideration of the private enterprise to start commercial and industrial activities is to earn maximum profits. They are normally not interested in setting up those industries which take a long time to complete, require heavy capital investment and where return on investment is low. The government had to step in to initiate those commercial and industrial ventures which required huge capital investment and were essential to build up a strong industrial base. These enterprises were necessary to accelerate the pace of industrial growth in the country. As a result basic and key industries such as, transport and

communication, power, fertilisers, iron and steel and cement were set up in the public sector The state entry into business was seen as an instrument for achieving the objective of economic development besides certain social objectives such as generating employment, controlling monopolies and providing essential commodities.

The reasons for government participation in business are discussed below:

(i) Planned development The pace of development of certain sectors in the economy was slow and inadequate This resulted in a lopsided development of the economy Therefore the Government through its *five year plans* lay down certain guidelines for economic development. The public sector enterprises establish industrial and commercial undertakings in these spheres as per the priority given in the plans.

(ii) Infrastructural facilities Rapid industrialisation is possible only with a sound and large industrial base in the country. This requires heavy investment in basic industries like power, fuel, transportation and machine tools Private enterprises were unable and unwilling to enter these areas. Therefore, it was imperative for the government to start such industrial undertakings.

(iii) Balanced regional development The decision regarding setting up business enterprises in the private sector is made purely on economic considerations. As a result industries may tend to be concentrated in certain parts of the country This may create problems of regional imbalances The public enterprises are specially set up in industrially backward regions to reduce regional disparities Some of the State Governments have set up Backward Areas Corporations to look into the industrial development of their respective areas.

(iv) Generation of employment. The government is responsible for providing employment opportunities to its citizens The public sector helps in expanding employment opportunities by establishing public enterprises in different parts of the country

(v) Model employers Labour welfare is the constitutional obligation of the state. Public enterprises provide better facilities to their workers in the form of housing, medical aid and other welfare amenities. For example, Bharat Heavy Electricals Limited (BHEL) and Indian Drugs and Pharmaceuticals Limited (IDPL) have built up townships for the benefit of their employees. The government thereby set an example for the private sector to follow

(vi) Social welfare Many of the public enterprises are guided by the service motive They provide goods and services which may be essential to the society at large at reasonable prices For example, Food Corporation of India and Fertilizers Corporation of India supply food grains and fertiliser at reasonable prices.

(vii) Equitable distribution of economic gains: The government, by controlling large scale business enterprises, has ensured an equitable distribution of income By providing competition to the private sector, they regulate monopolies and reduce concentration of economic power in few hands.

(viii) Nationalisation: Certain private industrial units were running at a loss The owners of these units would like to close them down The closure of such units may render many people unemployed. The government therefore has to look into the interest of the workers and take necessary action to prevent the closure of these units Such units may be taken over by the government in the public interest For example, National Textile Corporation (NTC) was set up by the government to take over the sick textile units

Prior to nationalisation, banks and insurance companies were in the private sector. The owners of these institutions were utilising the funds which they obtained from the public for building up their own business empires. Therefore the government had to step in to take over these institutions to ensure proper utilization of funds.

6.6 FORMS OF ORGANISATION

The forms of organising public enterprises are the following:

1. Departmental Undertaking;
2. Public Corporation;
3. Government Company.

6.6.1 Departmental Undertaking

This is the oldest and traditional form of organising public enterprises. Under this form, a Departmental Undertaking is organised, controlled and financed by the government. It is run on the same lines as any other government department. All the policy matters and other important decisions relating to the undertaking are taken by the controlling ministry. Parliament lays down the general policy of such undertakings. Enterprises such as Railways, Public Works Department (PWD), Post and Telegraphs, Ordnance factories, Delhi Milk Scheme are organised under this form of organisation.

Features

The features of a departmental undertaking are as follows:

(i) No separate entity: Such an enterprise does not possess a separate legal entity of its own. It is like any other government department. It cannot sue any other party without the consent of the government.

(ii) Management and control: The enterprise is managed by the government department under the direct control of the Ministry. The concerned minister incharge of the department is directly responsible to the Parliament or Legislature for it's operation. The day to day management is generally entrusted to civil servants (government officials).

(iii) Finances from the government funds. The departmental undertaking is financed from the treasury. Its revenues contribute to government funds. It does not have the power to borrow funds from any other source except with the consent or approval of the government.

(iv) Accounting control: The enterprise is subject to budgetory, accounting and audit controls applicable to other government departments.

Merits

The merits of a departmental form of organisation are:

(i) Easy to form: There are no legal formalities required in its formation. It comes into existence by an administrative order of the government. It does not require registration or any special legislation to bring it into existence.

(ii) Easy financing: It is financed through direct allocation of funds from the ministry concerned.

(iii) Secrecy: It is suitable for those business activities where secrecy and strict control is needed such as defence industry.

(iv) Accountability to people through Parliament: It is accountable to the Parliament for all its actions. Such accountability ensures proper utilisation of funds. If anything goes wrong with the functioning of an enterprise, the matter can be raised in Parliament.

Demerits

The demerits of a departmental form of organisation are:

(i) Lack of flexibility: A departmentally managed enterprise is subject to rigid rules and regulations of the government. Such rules often conflict with sound commercial practices and creates problems in the smooth operation of the departmental undertaking. It lacks flexibility so essential to a business organisation. For example, the practice in a particular industry may be to give 45 days credit to dealers, but the rules in a departmental undertaking may not allow credit for more than 15 days.

(ii) Absence of professional management: The civil servants (officials) who run the day to day affairs of the enterprise possess neither business experience nor professional skill necessary for the management of a business.

(iii) Delay in decisions: A departmental undertaking is run on bureaucratic lines which means a great deal of paper work and the necessity of putting everything in writing. This implies handling of files by several persons and hence unnecessary delay in decision making. Every decision taken is put on record and the responsibility is fixed on the person concerned. Therefore officials are hesitant to assume responsibility. As a result urgent decisions are kept pending.

(iv) Low efficiency: The departmental undertakings are subject to close scrutiny, criticism and investigation by parliament This reduces the initiative of the managers. They hesitate to use their discretion which may be required for efficient operations.

(v) Lack of autonomy: These enterprises are controlled by the ministry concerned. The managers have to refer all important matters to the minister This limits their freedom of action. They are not allowed to take decisions on their own and so do not possess autonomy

(vi) Over emphasis of political considerations: Political considerations assume more importance than business considerations in the running of the undertaking For example, while extending railway lines to new areas, often the effect of extending railways on the voting pattern of the area becomes more important.

Despite drawbacks, the departmental form of running the public enterprise is suitable for such business activities which are of vital importance for the country such as Defence, Telecommunications and Atomic Energy.

6.6.2 Public Corporation

The public corporation as a form of organisation is defined as an organisation created by a Special Act passed by the Central or State Legislature. The Act creating a public corporation prescribes its aims, objects and its relationship to departments and ministries.

A public corporation is managed generally by a Board of Governors/Directors appointed by the government

Once it is set up, the corporation has a separate legal entity. Being an autonomous body they prepare their own budgets Its financial powers are laid down in its rules Although initial capital of these corporations is contributed by the government, they are also permitted to raise loans from the public in the form of bonds

These days many commercial and industrial activities of the government are conducted through public corporations. Some of the well known public corporations are Industrial Finance Corporation of India, Food Corporation of India, National Thermal Power Corporation, Oil and Natural Gas Commission, Air India, Indian Airlines, Life Insurance Corporation.

Features

The features of a Public Corporation are:

(i) Created by a special act A public corporation is created by a special act. It has a separate legal entity distinct from the government or government departments.

(ii) Management and control: Its broad policies are determined by the parliament. The Board of Directors who manage the corporation are appointed by the government. It enjoys independence in its day to day working.

(iii) Capital allocation by government: The initial capital is provided by the government. It is expected to meet its expenditure from its revenue earnings from the consumers of its goods and services

(iv) Borrowing of funds: It can borrow funds from the government as well as from the public. It can also approach the government for additional funds.

(v) Budgeting and audit: It has the powers to frame it's own budget and make alterations thereof. It is not subject to any restrictions regarding the budget.

(vi) Staff recruitment The employees are recruited by the corporations according to their own requirements. The terms and conditions are determined by its Board They are not regarded as government servants

(vii) Service motive The primary objective, apart from earning profit, is public service.

Merits

A public corporation has certain distinct merits:

(i) Initiative. Management can take initiative and also be enterprising in its day to day management

(ii) Internal autonomy Being an autonomous organisation it is free from the rigid rules and regulations of the government It can, therefore, follow commercial practices in carrying on its business activities. As such it can lend a great deal of operating flexibility to its working.

(iii) Public accountability The functioning of a public corporation is subject to parliamentary enquiries. The management therefore is conscious of keeping public interest in mind

Demerits

A public corporation has the following demerits:

(i) Lack of autonomy in practice. Something which is accepted in law does not actually happen in practice Although it is set up as an autonomous organisation, it is regarded as an extension of the ministry. Most of the decisions are taken by the top officials in consultation with the Ministry. At times decisions are made on political considerations.

(ii) Unresponsive towards consumer interests: Generally public corporations are set up as a monopoly and do not have to face competition from private enterprises Therefore management becomes slack about efficiency in operations and tends to neglect consumer needs.

(iii) Problems of large size These corporations involve heavy capital expenditure. As the size of such corporations is also large many problems occur which can not be resolved easily For example, workers disputes on small issues may disrupt the normal working of the organisation. Such situations are normally averted in small organisations

(iv) Difficulty in changing the Act A public corporation is created by a special Act passed by the Central or State Legislature. Therefore any changes in the Act have to be approved by their respective Legislatures. This involves a lot of procedural formalities and hence delays.

Having examined the merits and limitations of Public Corporation it may be concluded that this form of organisation for public enterprises is suitable for setting up those undertakings:

- which require a huge amount of initial capital,
- where public interest must be kept in view by the management;
- where the enterprise has to be run on business lines

6.6.3 Government Company

The government company is defined as an enterprise set up under the Companies Act in which the government owns at least 51% of the share capital It is a convenient method of setting up a public enterprise. Such a company is established by an administrative decision of the government. It does not require a special act to be passed by the parliament as is required in the case of public corporations

It possesses the necessary freedom in raising capital from the public. Further, the management of a company is free from direct government control However it is subject to control by the government through review by Parliamentary committees The majority of Public Enterprises

are set up as government companies. Some of the examples are, Hindustan Machine Tools (HMT), State Trading Corporation (STC), Maruti Udyog Ltd., SAIL, Coal India Limited.

Features

The features of a government company are.

(i) Creation It comes into existence by the executive decision and action of the government. There is no need for a special act of legislature for its creation.

(ii) Registered body. It is an organisation registered under the Companies Act. It has many common features of a registered company in the private sector

(iii) Ownership. The government company may be wholly or partly owned by the central or state government. In case it is partly owned then at least 51% of the share capital must be held either by the Central or State government or by both.

(iv) Regulated by the companies act It is governed by the provisions of the Companies Act, 1956. Its objectives, functions, powers, scope of activities and area of operations are defined in the documents prepared under the Companies Act. However the government by notification can direct that any of the provisions of the Companies Act shall not apply to a government company. For example, a government company may not use the words 'private' or 'limited' as part of its name which is compulsory in private sector companies.

(v) Appointment of directors: All or majority of directors are appointed by the government depending upon the share owned by the government in a particular enterprise.

(vi) Raising of capital The government subscribes to the whole or part of the share capital of the company. It can raise additional capital through subscriptions from the government or public.

(vii) Staff recruitment. The company can recruit personnel as per its requirements. The terms and conditions are determined by the Board of Directors. Its employees do not form part of civil service.

(viii) Operational autonomy The management of a company is conducted independently. They can frame their own rules and regulations for internal management like any other company in the private sector They can prepare their own budget and can appoint auditors for the annual audit of accounts

Merits

The merits of government company are:

(i) Easy to form. It can be formed like a joint stock company in the private sector Its formation requires compliance of certain legal formalities, as laid down in the Companies Act It does not require any special Act to bring it into existence

(ii) Flexibility of raising capital: Government companies can also raise capital from the public to the extent it is not subscribed by the government.

It can associate private enterprises (national or foreign) to participate in its share capital Sometimes the government may not be in a position to meet its total capital requirements. In such circumstances, private and foreign enterprises may be invited to subscribe to its share capital

(iii) Operational flexibility. It possesses the necessary freedom of making rules and regulations relating to the management of the enterprise It is free from complicated procedures. It is suitable for being run on business principles which promote action and initiative. Since they have to compete with private sector companies, a certain level of efficiency is maintained

(iv) Facilitates acquisition of sick units: Sometimes the government may like to acquire shares in an existing private enterprise of national importance Its activities, finances and management may have to be regulated The take-over of such a sick enterprise is easy in a company form of organisation.

(v) Easy to amend documents A government company can alter or amend its legal documents without the approval of parliament. It is to follow the procedure laid down in the Companies Act.

Demerits

The demerits of a Government Company are:

(i) Lack of accountability· A government company is not under close scrutiny of the parliament. Therefore it is possible that they may not fulfill certain public expectations

(ii) Absence of real autonomy· The Board of Directors is dominated by official representatives of the various ministries The concerned department of the government is always consulted by the Board of Directors on every important policy matter.

(iii) Lack of professional skill and experience. The top management of a government company is deputed from government departments. They do not possess the necessary skill and professional experience for managing a commercial enterprise. As such industrial culture is replaced by the civil service culture. Gradually attempts have been made by government to reduce this limitation

(iv) Lack of continuity in policies and management. The top management and chairmen of these companies keep on changing. Rules, policies and procedures are subject to change by these top officials Hence there is no uniformity in practices followed by the company from time to time.

Despite the demerits discussed above, government companies are considered a popular form of public enterprise They are suitable when.

— the enterprise has to be run on business lines;
— the enterprise has to compete with other companies in the private sector;
— subscriptions from private and foreign enterprises have to be invited.

COMPARISON AMONG VARIOUS FORMS OF PUBLIC ENTERPRISES

	Basis	*Departmental Undertaking*	*Public Corporation*	*Government Company*
1	Formation	Created by an executive order of the government	Created by a special Act of the Central or State Legislature	Created by the Indian Companies Act, 1956
2	Legal status	No separate entity A part of the government department/ ministry	Separate legal entity	Separate legal entity
3	Capital	Whole capital is allocated from the budget of the concerned ministry	Initial capital is provided by the government	At least 51% of share capital is provided by the government and 49% can be raised from other sources
4	Borrowing powers	Can borrow from public with the prior approval of the government	Can borrow funds from the government as well as from public in the form of bonds/public deposits	Can borrow funds from the government and public in the form of bonds/public deposits
5	Control/ Management	Government officials of the concerned ministry	Directors nominated by the government	Majority of Directors appointed by the government

	Basis	Departmental Undertaking	Public Corporation	Government Company
6	Staff pattern	Civil servants—All government employees	Employees are recruited by the corporation	Employees are recruited by the company
7	Flexibility	No flexibility in its working Subject to rigid rules and regulations of the government	Great deal of operating flexibility in its internal working	Enjoys flexibility It can frame its own rules and regulations
8.	Degree of autonomy	No autonomy as it is part of the government department	Autonomy to a very large extent in its' day to day working	Substantial autonomy

Forms of Organisations in the Private and Public Sectors.

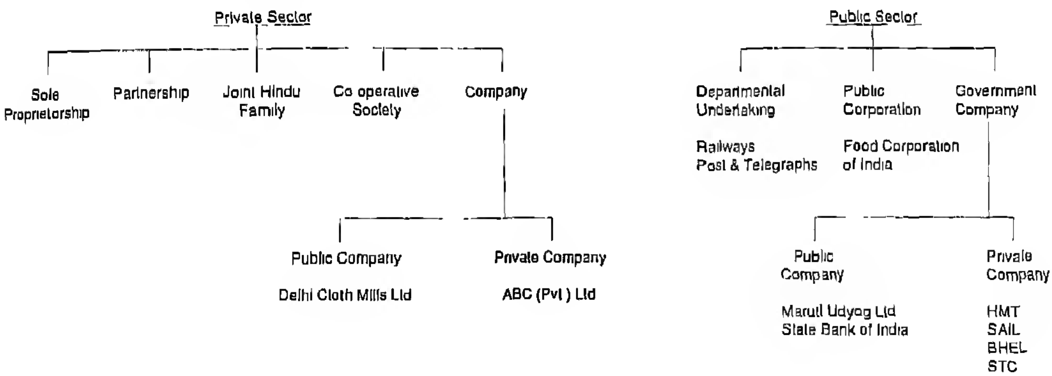

Fig. 6.1

SUMMARY

The company form of business organisation is very popular in the world today Companies may be classified as private, public and government companies

1. Private Company

A private company is one which restricts its membership to a maximum of 50; is prohibited from inviting the public to subscribe to its capital, and restricts transferability of its shares The private company enables a small group of persons to control the management of the company without the risk of displacement by a large shareholding group

2. Public Company

A public company is one which does not have any of the restrictions that apply to a private company It is an ideal form of organisation for starting business on a large scale

3. Government Company

A government company is one which is started by government and of which majority of capital is subscribed by the Central and/or state government(s)

4. Multinational Company

A multinational company is an organisation which operates in more than one country, carries out production, marketing and research activities in those countries, and attempts to maximise profits world-over.

5. Privileges of a Private Company

A private company enjoys several privileges as compared with a public company. It can be formed with only two members, need to have only 2 directors, and is not required to maintain an index of members Further, it is not required to get the approval of government for granting loans to Directors It is also exempt from certain legal formalities

6. Public Enterprises

'Public Sector' refers to the economic and social activities undertaken by public authorities (central and State governments, municipalities, etc). 'Private Sector' on the other hand, refers to economic and social activities performed under individual or group ownership. Organisations set up in the public sector are known as 'public enterprises'. These are also known as 'public undertakings' or 'public sector undertakings'.

The objectives of setting up public enterprises are (i) to bring about rapid economic development by promoting large-scale industries, (ii) to develop industries which facilitate growth, (iii) to bring about balanced regional growth, (iv) to prevent monopoly and monoplistic tendencies; and (v) to ensure adequate supply of essential goods

The main features of public enterprises are State ownership, control and financing, emphasis on socio-economic objectives, and public accountability.

The reasons for government participation in business are · Economic development according to planned priorities, develop infrastructural facilities; to secure balanced regional development; generate employment oportunities; provide model employment conditions; social welfare, equitable distribution of economic gains; and facilitate nationalisation.

Public enterprises may be organised as (i) Departmental undertaking; (ii) Public corporation and (iii) Government company

7. Departmental Undertaking

A departmental undertaking is organised, controlled and financed by the government or a local

authority. Its special features are. It has no separate legal entity It is managed as a government department under the direct control of the ministry It is financed from the government treasury and its revenues contribute to government funds

A *departmental undertaking* is suitable for those activities where secrecy and strict government control are essential It is accountable to the public through legislature.

8. Public Corporation

The public corporation is an autonomous organisation which is established by a special Act of the Central or State Legislature Once set up, the corporation has a separate entity The Act prescribes its aims, objects and relationship to government departments and ministries. Its broad policies are determined by the legislature or parliament Initial capital is allocated by government, while funds can be borrowed from the government or other sources It prepares its own budget and recruits employees on terms and conditions determined by the Board of Directors. Members of the Board of Directors are appointed by the Government.

Public Corporation is most suitable for setting up undertakings which require heavy capital investment, where public interest must be kept in view, and where the enterprise has to be run on business lines

9. Government Company

A Government Company may be defined as an enterprise set up under the Companies Act, and in which the government owns at least 51% of the share capital. Such a company is established by an administrative decision of the government It possesses the necessary freedom of raising capital from the public as well Its objectives, powers, scope of activities and area of operations are defined in the documents prepared for registration under the Companies Act However, it is also subject to control by the government through review by parliamentary committees.

Government companies are considered to be a suitable form of public enterprise when (i) the enterprise has to be run on business lines; (ii) it has to compete with other companies in the private sector, and (iii) subscription of capital from the private sector and foreign enterprises has to be invited

QUESTIONS

I OBJECTIVE TYPE QUESTIONS

Which of the following statements are right and which are wrong?

1 In a public company, the maximum number of members depends upon the number of shares issued,
2. A private company can manage its affairs with a minimum of 3 directors.
3 Indian Oil Corporation is a public corporation
4. A company which buys from other companies in two or more foreign countries is known as a multinational company
5 Public enterprises are established only for promoting social welfare
6 Public enterprises are accountable to the people through the minister

Match the expressions in columns A and B.

	Column A		*Column B*
(i)	Departmentally managed public enterprise	(a)	Majority ownership of government
(ii)	Public Corporation	(b)	Issue of Prospectus
(iii)	Government Company	(c)	Minimum of 2 Directors
(iv)	Public Company	(d)	Enterprises under individual or group ownership
(v)	Private Company	(e)	Lack of Flexibility of operation
(vi)	Private Sector	(f)	Special Act of Legislature

II SHORT ANSWER TYPE QUESTIONS

1 Enumerate the types of company form of organisation.
2. Define — Multinational company
3 What do you mean by 'Private Sector' and Public Sector?
4 Under what circumstances is the departmental form of organising a public enterprise most suitable?
5 What is a 'Public Corporation'?
6 Name at least two public corporations in India
7. When is government company most suitable for organising a public enterprise?

III ESSAY TYPE QUESTIONS

1. Distinguish between private company and public company
2. What are the objectives of business enterprises in the public sector? Give reasons to justify government participation in commercial and industrail activities
3 What are the features of public corporation as a form of organisation of public enterprises? What are its merits and drawbacks?
4. In what ways is the company form of organising a public undertaking superior to the departmental form? Name at least two government companies in India.
5. Outline the special features of departmental undertakings in the public sector, their merits and demerits
6 Attempt a comparative view of the three forms of organising public enterprises

CHAPTER 7

Formation of A Company

LEARNING OBJECTIVES

After reading this chapter, you should be able to:

1. identify stages in the formation of a company;
2. explain the meaning and functions of promoters;
3. enumerate the documents required for the incorporation of a company;
4. distinguish between Memorandum of Association and Articles of Association;
5. describe the nature and importance of prospectus.

7.1 INTRODUCTION

In the earlier chapters, we have discussed the meaning and nature of a company and the salient features of two basic types of companies, namely, *private company* and *public company* We shall now study the concept of 'promotion' and the stages and documents involved in the formation of a company.

A company comes into existence after a series of steps have been taken These steps can be broadly grouped under the following three important stages

(1) Promotion,

(2) Incorporation or Registration, and

(3) Floatation.

A public company has to pass through all the three stages before commencing business But a private company is formed and can commence business immediately after the first two stages are completed Each of these stages is discussed below.

7.2 PROMOTION

Promotion is concerned with bringing a business into existence It involves identification of some business opportunity or idea and taking steps to implement it through the incorporation and floatation of a company. The persons who identify a business idea and undertake to start a company to give a practical shape to the idea are known as *promoters*. The process of promotion begins when the promoters feel that a business activity can be profitably undertaken by a company It involves a study of the practicability of the proposed business, taking up the formation of a company to undertake it and taking necessary steps to get it going.

Who is a Promoter?

A promoter is one who identifies a business opportunity, analyses its prospects and initiates steps to form a company with reference to the business opportunity. A promoter is always on the look out for business opportunities, such as the possibility of (a) selling a product by new methods, (b) manufacturing a product by new methods, (c) introducing a product with new uses, (d) introducing a new type of package, or (e) selling a product in a new market An opportunity which is likely to be more profitable will be picked up by the promoter.

A promoter may be an individual, a firm, a company, an institution, or even a government department Jamsedji N Tata, Ghanshyam Dass Birla, Gagalbhai Mafatlal and Gujar Mal Modi are some of the well known individual promoters. The Government of India has promoted several enterprises such as BHEL, STC, FCI, etc

Role of Promoters

A company comes into existence as a result of the efforts of the promoters After identifying a business opportunity, the promoters undertake the formation of a company They also arrange for making various resources available to get the company going. The role of promoters may be discussed under the following sub-heads

(i) Identification of business opportunity The promoters identify an opportunity which could be taken up by a business concern. They undertake a preliminary study of the market to ascertain if the new product or service will sell.

(ii) Detailed investigation. Having identified a business opportunity, the promoters undertake a detailed examination to satisfy themselves regarding the profitability of the proposition Among other things, they have to consider the volume of the product which could be sold, nature of competition in the market, availability of factors of production, probable cost of production and the amount of profit expected.

(iii) Ensuring availability of resources The promoters arrange for the procurement of human resources, materials, machinery and equipment, etc for the company These resources may not be

physically assembled before the incorporation of the company, but contracts to ensure their availability may be entered into The promoters have also to arrange funds to meet the preliminary or initial expenses of bringing the company into existence

(iv) Canvassing. The promoters need signatories to the Memorandum of Association For this purpose, they approach a few influential people and persuade them to be associated with the formation of the company. At least seven signatories to Memorandum are required in case of a public company and two in case of a private company

(v) Making contracts. The promoters negotiate terms and conditions for engaging brokers and arrange with bankers, solicitors and auditors to successfully launch the company.

7.3 INCORPORATION OR REGISTRATION OF A COMPANY

A company comes into existence only when it is registered with the Registrar of Companies For this purpose, the promoters have to take the following preparatory steps:

(i) To ensure the availability of the name by which the proposed company is to be registered. For this purpose, the promoters have to fill in a 'Name Availability Form' and deposit it with the Registrar of Companies alongwith the necessary fees. Generally, three names are proposed in this form If all the names are rejected by the Registrar, new names have to be proposed.

(ii) To get Memorandum of Association and Articles of Association prepared with the help of legal experts and submit to the Registrar of Companies for approval.

(iii) To get signatures on the Memorandum of Association and Articles of Association of those who have agreed to form a company. Such persons are also known as 'signatories to Memorandum of Association'.

(iv) To get Memorandum of Association and Articles of Association printed. These documents must be properly stamped before they are filed with the Registrar of Companies.

Filing of Documents

After going through the above steps, the promoters make an application for the incorporation of the company. The application must be submitted to the Registrar of Companies in the state in which the registered office of the company is to be situated and accompanied by the following documents.

(i) Memorandum of Association;

(ii) Articles of Association;

(iii) Written consent of the persons who have agreed to become directors of the company;

(iv) Notice of address of the registered office of the company It may, however, be filed within 30 days of incorporation;

(v) A statutory declaration stating that all the legal requirements of the Companies Act with regard to incorporation have been complied with. This declaration may be made by the Company Secretary, Managing Director, a Chartered Accountant, Advocate of High Court or any other person associated with the formation of the company.

Before filing the above documents, necessary filing fees and registration fees at the prescribed rates are also to be deposited.

Certificate of incorporation

The Registrar will scrutinize the above documents. If he is satisfied, he will enter the name of the company in the 'Register of Companies' and will issue a 'Certificate of Incorporation'. The moment this certificate is issued, the company acquires a separate legal status

The Certificate of Incorporation bears the serial number, date of incorporation and the

signature and seal of the Registrar of Companies It is a conclusive proof that all legal formalities required for incorporation of a company have been duly fulfilled

A private company or a public company not having *share capital* can commence business immediately after its incorporation. But a public company having *share capital* has to pass through another stage, namely, floatation stage, before actually starting its business operations

7.4 FLOATATION

Floatation of a company means to get it going. For this purpose, a public company has to pass through two sub-stages, namely, (a) *raising of capital*, and (b) *getting Certificate of Commencement of Business*. These are discussed below·

Raising of Capital

Also known as 'capital subscription stage', this stage leads to raising of necessary capital for meeting the financial requirements of the company In order to raise capital, the Directors of the company have to take the following steps:

(i) Consent of controller of capital issues In order to raise share capital, the permission of the Controller of Capital Issues is to be obtained as per prevailing Government rules

(ii) Filing of prospectus· A prospectus is a notice, circular, advertisement or any other document issued by a company to raise funds from the public. It must be properly drafted and printed and then filed with the Registrar of Companies before it is circulated among the public. A public company not issuing a prospectus has to file a 'Statement in lieu of Prospectus' with the Registrar of Companies.

(iii) Allotment of shares. Applications for shares are received from the public through the company's bankers named in the prospectus The applications are processed and then shares are allotted to the successful applicants.

Minimum subscription must have been raised before allotment of shares is done Minimum subscription refers to the minimum amount of capital which must be raised by the issue of shares to do the business (e g. acquisition of fixed assets, working capital and payment of underwriting commission, brokerage, etc) The amount of minimum subscription must be specified in the prospectus

Commencement of business

A public company cannot start its business operations unless it has obtained the Certificate of Commencement of Business from the Registrar of Companies For getting this certificate, the company will have to file the following documents with the Registrar·

(i) A declaration to the effect that minimum subscription as mentioned in the prospectus has been obtained;

(ii) A declaration that the directors have paid, on shares held by them, an amount equal to what has been called up from other shareholders;

(iii) A declaration by the secretary or one of the directors that the requirements in respect of commencement of business have been complied with.

The Registrar will scrutinise these documents If he is satisfied, he shall issue a certificate certifying therein that the company is entitled to commence business. It is known as Certificate of Commencement of Business It bears the serial number and date of issue of the certificate. It also contains the signature and seal of the Registrar. It is after getting this certificate that the process of formation of a public company is complete and the company can start its business.

7.5 IMPORTANT DOCUMENTS IN COMPANY FORMATION

We have already learnt that a number of documents have to be filed with the Registrar of Companies for the incorporation and floatation of a public company Three such documents are.

(i) Memorandum of Association;
(ii) Articles of Association,
(iii) Prospectus. (In case a public company does not want to raise capital from the general public, it will have to file a *Statement in lieu of Prospectus* with the Registrar of Companies.)

The nature and significance of these documents is discussed below:

7.5.1 Memorandum of Association

The Memorandum of Association is the principal document of the company. It is it's constitution or charter and sets out the limits within which the company must always function. The purpose of the Memorandum is to enable the shareholders and outsiders who deal with the company to know the range of activities of the company It is a public document and the parties dealing with a company may ask for its copies on payment of a nominal charge

The Memorandum of Association must be divided into paragraphs which are numbered consecutively and printed. It must be signed by the persons who have agreed to form a company in the presence of at least one attesting witness.

Contents of Memorandum of Association. The Memorandum of Association contains the following clauses·

1. Name clause: Under this clause, the name of the company is stated. Any suitable name may be chosen subject to the following restrictions:

(i) The name of a company must end with the word *'Limited'* if it is a public company and with the words *'Private Limited'* if it is a private company. Use of these words is not required in case of companies set up for the promotion of art, science, culture, etc;
(ii) The proposed name should not convey that it has any patronage of the Government;
(iii) The proposed name should not be identical or similar to the name of any existing company;
(iv) The proposed name should not be objectionable in any other manner It must not hurt the feelings of any section of the society.

2. Registered office clause: This clause contains the name of the State in which the Registered Office of the company is to be situated. This is required in order to fix the domicile or the place of registration of the company Alongwith the name of the State, the address of the Registered Office may also be mentioned in the Memorandum. If it is not so mentioned, it may be notified to the Registrar of Companies within 30 days of the incorporation of the company.

3. Objects clause: This may be regarded as the core of the Memorandum as it sets out the objects with which a company is registered.

The objects mentioned in the Memorandum lay down the maximum permitted range of activities in which the company may engage and beyond which it cannot go. The objects clause must specify the objects of the company in the following order.

(i) the main objects of the company to be pursued by the company on its incorporation and the objects incidental or ancillary to the attainment of the main objects, and
(ii) other objects of the company not included in the above clause.

4. Liability clause: This clause states that the liability of members is limited to the amount which they have agreed to contribute. This tells the outsiders as to how far they can hold the members liable for the debts of the company

5. Capital clause: Every company having share capital must state the amount of its share capital with which the company is proposed to be registered It is also required to state the division of share capital into shares of fixed denomination

6. Association or subscription clause: It contains a declaration by the signatories or subscribers to the Memorandum that they are desirous of forming themselves into a company. Each subscriber signs the Memorandum in the presence of a witness. There must be at least seven signatories to the Memorandum in case of a public company and at least two in case of a private company

7.5.2 Articles of Association

The Articles of Association of a company contain the rules relating to the administration of its internal affairs. They define the duties, rights and powers of the management (or Board of Directors). They lay down the mode and form in which the business of the company is to be carried on and the manner in which the changes in the internal rules of the company may be made from time to time.

The Articles of Association of a company must be divided into *paragraphs*, *numbered* consecutively and *printed* It must be signed by the signatories to the Memorandum in the presence of at least one attesting witness.

Generally, the companies prepare their own Articles of Association. However, a public company limited by shares may adopt the model set of Articles given in Table A of the Companies Act Other types of companies must prepare and file their own Articles of Association alongwith Memorandum at the time of incorporation

Contents of Articles of Association The Articles of Association of a company contain rules, regulations and by-laws for the management of the internal affairs of the company Some of the more important matters are listed below:

(i) The amount of share capital and different classes of shares;
(ii) Rights of each class of shareholders;
(iii) Procedure for making allotment of shares;
(iv) Procedure for issuing share certificates;
(v) Procedure for transfer of shares;
(vi) Procedure for the conduct of meetings;
(vii) Appointment, removal and remuneration of directors and their powers and duties;
(viii) Procedure regarding alteration of share capital;
(ix) Matters relating to distribution of dividend;
(x) Matters relating to keeping of statutory books such as Register of Members;
(xi) Procedure regarding the winding up of the company

DIFFERENCE BETWEEN MEMORANDUM AND ARTICLES OF ASSOCIATION

	Basis	*Memorandum*	*Articles*
1	Purpose	The basic purpose of the Memorandum of Association is to lay down the charter or the constitution of the company	The basic purpose of Articles of Association is to provide rules and regulations for the internal management of the company
2.	Contents	It defines objects of the company and the scope of its activities	It lays down procedures to achieve objects stated in the Memorandum
3	Supremacy	It is the fundamental document of the company	It is a supplementary document and is subordinate to the Memorandum
4.	Relationship	It governs external relations between the company and outsiders	It governs primarily internal relations, i e, relations between company and its directors
5	Filing	It must be filed with the Registrar of Companies	Filing of Articles is not compulsory when a company adopts the model articles given in Table-A

7.5.3 Prospectus

A prospectus may be defined as any notice, circular, advertisement or any other document inviting offers from the public for the purchase of its shares or debentures or for making deposits with it. Thus, a prospectus is issued by a company to the public to raise funds. It explains the prospects of the company to the general public. Its purpose is to arouse the interest of the investors in the company. It serves as an invitation to the public to make deposits with the company or invest in the shares and debentures issued by it. Prospectus is an important document because of the following reasons:

(i) It serves as an invitation by the company to the public to invest in shares and debentures issued by it.
(ii) It acts as a medium of advertisement. It helps the company to inform the public about its present operations and future prospects.
(iii) It serves as a record of the terms and conditions of the issue of shares and debentures.
(iv) It protects the interests of the investors. If there is any misstatement in the prospectus, the promoters and directors, who authorise the issue of the prospectus, will attract both civil and criminal liability under the Companies Act.

Contents of a prospectus. Prospectus is the document through which the prospective investors can judge the soundness and prospects of the company. In view of this, the Companies Act requires the fullest disclosure of all material and essential particulars, which can affect the decision of the investor to invest in the company. The Act provides that a prospectus issued by or on behalf of the company must state the matters, and set out the reports specified in Schedule II given at the end of the Companies Act.

Some of the important matters to be included in the prospectus are as follows.

(i) Company's name and address of its registered office
(ii) Main objects of the company.
(iii) The number and classes of shares
(iv) Names, addresses and occupations of the signatories to the Memorandum
(v) Names, addresses and occupations of directors and managing director
(vi) Names and addresses of company promoters and their track record.
(vii) Particulars of every material contract.
(viii) Names, addresses and other particulars of brokers, underwriters and bankers to the issue
(ix) Number and classes of shares of debentures offered to the public.
(x) Minimum subscription that must be raised before allotment of shares or debentures could be made
(xi) Time of opening and closing of subscription list.
(xii) The amount payable on application and allotment of each share or debenture
(xiii) Rights, privileges and restrictions attached to different classes of shares.
(xiv) The time and place at which copies of balance sheets and profit and loss accounts of previous years may be inspected.

Statement in lieu of Prospectus

A public company having share capital may decide not to approach the public for securing necessary capital if it is confident of obtaining the required capital privately. In such a case, it will have to file a "Statement in lieu of Prospectus" with the Registrar. A Statement in lieu of Prospectus is drafted in accordance with the particulars set out in Schedule III of the Act. This document contains information very much similar to a prospectus. It must be duly signed by all the directors and a copy thereof must be filed with the Registrar at least *three days before* the allotment of shares.

A private company cannot issue shares or debentures to the general public. So it is not required to issue a prospectus or a statement in lieu of prospectus

SUMMARY

Stages in Formation of a Company

There are three stages in the formation of a public company, namely (1) Promotion; (2) Incorporation, and (3) Floatation However, a private company need not go through the last stage as it can commence its operations soon after getting the Certificate of Incorporation.

1. Promotion

It involves identification of a business idea, studying its profitability and undertaking to implement the idea through the formation of a company The persons who assume this responsibility are known as promoters

2. Incorporation

A company comes into existence only when it is registered with the Registrar of Companies. The documents required for registration are as under.

(i) Memorandum of Association,
(ii) Articles of Association;
(iii) Written Consent of Directors;
(iv) Notice of Address of Registered Office,
(v) Statutory Declaration

A certificate of Incorporation will be issued if the Registrar is satisfied that all the legal requirements for incorporation have been fulfilled This will give the company a legal status independent of its members. A private company can start business after getting this Certificate. But a public company has to pass through another stage known as 'Floatation' stage

3. Floatation

The term 'floatation' means getting a business going It involves (a) raising of capital, and (b) obtaining Certificate of Commencement of Business.

(a) Raising of Capital. In order to raise capital, a public company follows the following procedure.

(i) Obtains consent of Controller of Capital Issues as per prevailing government rules
(ii) Filing of prospectus of Statement in lieu of Prospectus with the Registrar of Companies.
(iii) Receiving applications for shares from the public and undertaking allotment of shares

4. Commencement of Business

Certificate of Commencement of Business must be obtained from the Registrar before actually starting operations The formalities to be observed for obtaining this certificate are as follows:

(i) Declaration that minimum subscription has been raised
(ii) Declaration that the directors have paid the amount called on the shares held by them.
(iii) Declaration that all requirements in connection with commencement of business have been fulfilled

5. Important Documents

The important documents required for the incorporation and floatation of a company are as under:

(i) Memorandum of Association It is the charter of the company which defines the objects and

powers of the company. It must be filed with the Registrar to get a company registered

(ii) Articles of Association It contains rules and regulations for the internal management of the company It is subordinate to the Memorandum of Association of the company. A public company may adopt Table A if it does not want to prepare its own Articles of Association.

(iii) Prospectus It acquaints the general public about the operations of the company It is a sort of invitation to the general public to invest their funds in the shares/debentures issued by the company It must be filed with the Registrar before raising capital from the public

6. Statement in Lieu of Prospectus

It is filed with the Registrar of Companies if a public company does not want to issue a prospectus It contains information which is very much similar to a prospectus

QUESTIONS

I. OBJECTIVES TYPE QUESTIONS

1. Match the two groups:

	Group A		*Group B*
(i)	Memorandum of Association	(a)	Raising of Capital
(ii)	Articles of Association	(b)	Charter of Company
(iii)	Prospectus	(c)	Internal rules and regulations
(iv)	Promotion	(d)	Identification of business idea

2. State whether the following statements are *true* or *false*
   (i) A public company has to file a prospectus before incorporation
   (ii) Incorporation of a company is compulsory
   (iii) Articles of Association is the basic charter of a company
   (iv) Table A may be adopted in place of preparing the Memorandum of Association
   (v) A private company can commence business after its incorporation.

II SHORT ANSWER TYPE QUESTIONS

1 Who is a promoter?
2 What is Memorandum of Association?
3 What is Certificate of Incorporation?
4. List the main clauses of Memorandum of Association
5. State the reasons for issuing a prospectus.

III ESSAY TYPE QUESTIONS

1 What is meant by 'Promotion'? What are the functions of promoters?
2. Briefly discuss the procedure of formation of a public company
3 Describe the steps necessary in the formation of a company Name the important documents required in this process.
4. What is Memorandum of Association? List its important clauses.
5 Discuss the nature of Articles of Association How does it differ from Memorandum of Association?
6 What do you mean by a prospectus? Discuss its significance.

CHAPTER 8

Sources of Business Finance

LEARNING OBJECTIVES

After reading this chapter, you should be able to:

1. explain the importance of business finance;
2. identify the different types of financial needs of business;
3. distinguish between long, medium and short term financial requirements;
4. describe the various sources of business finance and enumerate the types of shares and debentures;
5. name the various financial institutions and explain their usefulness;
6. describe the terms 'retained profit' and public deposit; and
7. enumerate the functions of commercial banks

8.1 INTRODUCTION

All economic activities in the modern world centre round the use of money That is why the modern economy is sometimes called *money economy* The very existence of society today depends on the use of money. When money is used for any activity it is known as finance To finance means making money available when it is needed Business finance thus refers to procuring and using money for business purposes In this chapter, we shall discuss why money or finance is essential for business, the nature of financial needs, and the sources or methods of raising finance for business activities

8.2 NATURE AND SIGNIFICANCE OF BUSINESS FINANCE

No one can think of starting business activities or running a business without adequate funds at his disposal Every business requires some money to start which is called *capital*. When the business is expanded more money may be required. Obviously, if business is started on a small scale it will require a smaller amount of capital than a business which is started on a large scale. Larger the size of a business firm larger will be the amount required

While starting a business money is needed to procure assets which may include machinery, furniture etc A manufacturer will require raw materials for production. He must employ people and pay them for their work He must also pay the electricity bills, water bills, and incur other miscellaneous expenses. But production takes time to be completed. All expenses continue to be incurred until the goods are sold and money recovered. However, sales do not take place immediately and a part of the sales may also be on credit. Meanwhile production continues in anticipation of sales to be made later. So the amount realised on sale of goods and the recovery of dues from customers do not coincide at any point of time with the expenses incurred on operations. This may mean locking up of capital for some time Funds are required to bridge this time gap between production and sales. Thus necessity of finance arises not only at the commencement of business but also during the period that activities are on

Like manufacturers, traders must also spend money on procurement, transportation and storage of goods well in advance of the actual sales of the goods The importance of finance arises basically due to the time of waiting for sales to recover the continuing expenditure In the case of fixed assets acquired for business purposes, like building, plant and machinery, funds remain locked up for a longer period and there is longer waiting for recovery of the cost of those long lived assets. Availability of finance is therefore considered essential for day to day activities as well as for investment in durable (fixed) assets.

The importance of finance has increased and will continue to increase with the growth of business and industry This is because large scale production and distribution require considerably large amounts to be invested in business. It is beyond the capacity of one or two persons to provide necessary finance for large scale ventures. Hence, the problem of finance is overcome by the formation of joint stock companies which can associate a large number of people as shareholders. Loans can also be raised by companies against the security of assets

Even then, the necessity of finance does not come to an end at any stage. Additional funds are needed from time to time for expansion. Changing environment of business and increasing competition may require new methods of production or distribution to be adopted, or plant and machinery to be modernised, or new products to be introduced in the market In the absence of additional investment on such occasions it may be impossible for the business to survive.

Finance plays such a vital role in modern enterprises that it's often said to be the life blood of business Finance is needed at every stage in the life of a business It must be available at the proper time It must also be adequate for the purpose for which it is needed. Shortage of funds may ruin the business

8.3 TYPES OF FINANCE

We have mentioned above that funds are required by business firms for different purposes — *to acquire* fixed assets, *to provide* for operating expenses, and *to improve* methods of production, etc. Depending on the purpose to be served, we may distinguish between three types of finance. These are·

(i) Long-term finance
(ii) Short-term finance, and
(iii) Medium-term finance

(i) Long term finance: Funds which are required to be invested in the business for a long period (say more than five years) are known as *long-term finance*. It is also known is *long-term capital* or *fixed capital*. This type of finance is used for acquiring fixed assets such as land, building, plant and machinery, etc. The amount of long-term funds required naturally depends on the type of business and the investment required for fixed assets For example, the manufacture of steel, cement, chemicals, etc involve heavy expenses to be incurred on buildings, machinery and equipments. A small factory producing hosiery goods, or a small workshop repairing electrical goods will require much smaller investment in fixed assets. On the other hand, traders generally require lesser amounts for long-term investment as compared with the requirement of manufacturers This is because trading concerns do not require expensive long lived assets to use for their activities. The size of the business firm also determines the amount to be invested in fixed assets Large-scale manufacturing and trading activities will obviously require more long-term capital than small-scale enterprises

(ii) Short-term finance This type of finance refers to funds needed to meet day to day requirements and for holding stocks of raw materials, spare parts, etc. to be used for current operations *Short -term finance* is often called *working capital* or *short-term capital*, or *circulating capital*. The amount of such capital is required for a short period upto one year. As soon as goods are sold and funds are recovered the amount is again used for current operations. Generally speaking production processes are completed within a year and goods are ready for sale Hence short-term funds can be used over and over again from year to year. How much short-term finance will be required depends on (a) the nature of business undertaken, (b) the time gap between commencement of production or purchase of goods and their sale and (c) the volume of business. Trading firms normally require proportionately more of short term capital than long-term capital. Manufacturing concerns, on the other hand, need relatively smaller amounts of short-term capital as compared to long-term capital. Again if production time and the time-gap between production and sale is shorter (say one or two months), it will require much less short-term finance than if the time-gap is one year Let us take two examples, power looms produce textiles more quickly than handlooms Hence the use of power looms involves relatively smaller amounts of working capital than in the case of handloom production. The volume or scale of business activity also determines the amount of short-term finance. A small factory needs much less short-term capital than a large manufacturing enterprise.

(iii) Medium-term finance. Business firms often need funds for a period of 2 to 5 years for particular purposes. These may include expenses on modernisation of plant and machinery, or introduction of a new product, adoption of new methods of production or distribution, or an advertisement campaign. Finance required for any

such purpose is known as *Medium-term finance* or *medium-term capital*. The necessity of this type of finance generally arises on account of changes in technology or increasing competition Manufacturing industries are more often in need of such finance. The amount required depends on the nature of purpose in view. The expenditure incurred is regarded as an investment because increased income is expected out of it.

8.4 SOURCES OF FINANCE

The primary responsibility of financing a business venture is that of the owners of the business. But loans and credits also meet the financial requirements of business firms. In sole proprietorship business, the individual proprietor generally invests his own savings to start with. He may reinvest a part of the profits earned in course of time He may also borrow money on his personal security or the security of his assets. Similarly, the capital of a partnership firm consists partly of funds contributed by the partners and partly of borrowed funds. If necessary they may also decide to reinvest their own shares of profit.

The company form of organisation enables the promoters to raise necessary funds from the public who may contribute capital and become members (shareholders) of the company. In course of its business, the company can raise loans directly from banks and financial institutions or by issue of securities (debentures) to the public. Besides, profits earned may also be reinvested instead of being distributed as dividend to the shareholders

Thus for any business enterprise, there are two sources of finance, that is, funds contributed by owners, and funds available from loans and credits. In other words, the financial resources of a business may be provided by *owners' funds* and *borrowed funds* Let us examine the characteristics of these two sources.

1. Owners Funds or Ownership Capital: It consists of the amounts contributed by owners as well as the profits reinvested in the business. This is because profits ultimately belong to the owners.

One major characteristic of owner's fund as a source of finance is that it provides 'risk capital'. It is known as 'risk capital' because every business runs the risk of loss or low profits, and it is the owners who bear this risk. In the event of low profits they do not have adequate return on their investment If losses continue the owners may be unable to recover even their original investment after meeting the loan obligations However, in times of prosperity and in the case of a flourishing business the high level of profits earned accrue entirely to the owners of the business Thus after paying interest on loans at a fixed rate, the owners may enjoy a much higher rate of return on their investment Owners contribute risk capital also in the hope that the value of the firm will appreciate as a result of higher earnings and growth in the size of the firm.

The second characteristic of this source of finance is that ownership capital remains permanently invested in the business. It is not refundable like loans or borrowed capital. Hence a large part of it is generally used for acquiring long-lived fixed assets It is also used to finance a part of the working capital which is permanently required to hold a minimum level of stock of raw materials, a minimum amount of cash, etc. Besides, this type of finance is available for all purposes throughout the life of the business

Another characteristic of ownership capital relates to the management of business. It is on the basis of their contribution to equity capital that owners can exercise their right of control over the management of the firm. Managers cannot ignore the owners in the conduct of business affairs. The sole proprietor directly controls his own business. In a partnership firm, the active partners manage the firm on behalf of other partners But every partner has a right to take part in the management of business. A company is managed by directors who are elected by the members (shareholders)

Merits

Arising out of its characteristics, the advantages of ownership capital may be briefly stated as follows :

- (i) It provides risk capital
- (ii) It is a source of permanent capital
- (iii) It is the basis on which owners' acquire their right of control over management
- (iv) It does not require security of assets to be offered to raise ownership capital

Limitations

There are also certain limitations of ownership capital as a source of finance These are:

(i) The amount of capital which may be raised as owners fund depends on the number of persons prepared to take the risks involved, and their personal savings The capacity of the proprietor of a sole proprietorship firm is extremely limited to provide ownership capital. In a partnership concern, a few persons cannot provide ownership capital beyond a certain limit.

A joint stock company can raise large amounts by issuing shares to the public But it leads to an increased number of people having ownership interest and right of control over management This may reduce the original investors' power of control over management

(ii) Being a permanent source of capital, ownership funds cannot be reduced in a case of a company. Share capital is not refundable as long as the company is in existence This may mean a part of this fund remaining idle when there is no scope for expansion or fresh investment opportunities.

(iii) A company may find it difficult to raise additional ownership capital unless it has high profit-earning capacity, or growth prospects. Issue of additional shares is also subject to legal restrictions beyond a certain limit, as it may lead to concentration of economic power or monopoly

2. Borrowed Funds or Borrowed Capital cludes all funds available by way of loa credit

Characteristics. Loans are raised by bu firms for specified periods at fixed rates of est Thus borrowed funds may serve the pu of long-term, medium-term or short-ter nance.

Borrowing is possible on personal se but generally it is against the security of a Banks and financial institutions give against the security of assets. Various ty debentures can also be issued by a compar

Interest on such capital is payable a yearly or yearly intervals. The principal am to be repaid by the end of the period of lo other words, the borrowing firms have two of liabilities. One is to pay interest at r intervals, and the other is to repay the lo maturity These liabilities have to be met e the earnings are low or there is loss Mor borrowed funds cannot be used permanen any business.

Lenders and creditors do not have an of control over the management of the borr firm. Of course, they can sue the firm in court if there is default in payment of inte repayment of loan amount

Merits

From the business point of view, borrowed has several merits

- (i) It does not affect the owners' contro management;
- (ii) Interest is treated as an expense, so be charged against income and the a of tax payable thereby reduced;
- (iii) The amount of borrowing and its ti can be adjusted according to conve and needs, that is, it is a flexible so finance, and
- (iv) It involves a fixed rate of interest to l even when profits are very high

owners may enjoy a much higher rate of return on investment than the lenders.

Limitations

Against the above merits borrowed capital has certain limitations

(i) It involves fixed obligations. Payment of interest and repayment of loans cannot be avoided even if there is no profit. Default in meeting these obligations may create problems for the business To begin with business may suffer on account of decline of its credit worthiness Continuing default may even lead to insolvency of firm.

(ii) It requires adequate security to be offered against loans Borrowed funds are usually available upto 60-70 per cent of the value of assets Moreover, high rates of interest may be charged if the firm's ability to repay the loan is uncertain.

We have discussed above the characteristics of ownership capital (owners' funds) and borrowed capital (borrowed funds) as sources of business finance. Whether it is a trading or manufacturing concern, and whether it is a proprietary, partnership or company form of organisation, owners' funds and borrowed funds taken together meet the financial needs of business enterprises We have stated earlier that the company form of organisation is best suited for undertaking large scale business. This is mainly because a company is in a position to raise much larger amounts of capital than a proprietary or partnership firm. We shall now discuss the various methods which *companies* may adopt to raise both ownership capital and borrowed capital.

8.5 SOURCES OF COMPANY FINANCE

The sources from which a company generally raises financial resources may be described as (1) sources of long-term finance, and (2) sources of short-term finance. Some of these sources also serve the purpose of medium-term finance:

1 The sources of long-term finance include:
   (i) Issue of shares
   (ii) Issue of debentures
   (iii) Loans from financial institutions
   (iv) Retained profits, and
   (v) Public deposits
2. Sources of short-term finance are
   (i) Trade credit
   (ii) Bank loans and advances and
   (iii) Short-term loans from finance companies

Let us examine the characteristics and implications of each of the sources

8.5.1 Sources of long-term finance

1. Issue of shares: The amount of capital decided to be raised from members of the public is divided into units of equal value These units are known as 'shares' and the aggregate value of shares is known as 'share capital' of the company Those who subscribe to the share capital become members of the company and are called 'shareholders'. They are the owners of the company. Hence shares are also described as 'ownership securities.'

Two types of shares may be issued by a company to raise capital. (a) Preference shares, and (b) Equity shares The amount of share capital which is raised by the issue of preference shares is called 'preference share capital' The amount raised by the issue of equity shares is known as 'equity share capital.'

(a) Issue of preference shares: Preference shares are so called because the holders of such shares have preferential rights over equity shareholders

Preference shares have three distinct characteristics:

(i) Preference shareholders have the right to claim dividend out of profits at the fixed rate which is decided according to the terms of issue of shares In other words, if there is profit, dividend at a fixed rate must be paid to the preference shareholders. The balance, if any, can be distributed among other shareholders that is, equity shareholders. However, payment of dividend is not legally compulsory. Only when

dividend is declared, preference shareholders have a prior claim over equity shareholders

(ii) Preference shareholders have also the preferential right of claiming repayment of capital in the event of winding up of the company Preference capital has to be repaid out of assets after meeting the loan obligations and claims of creditors but before any amount is repaid to equity shareholders

(iii) Holders of preference shares enjoy certain privileges which cannot be claimed by the equity shareholders That is why, they cannot directly take part in matters which may be discussed at the general meeting of shareholders, or in the election of directors Depending upon the terms and conditions of issue, different *types* of preference shares may be issued by a company to raise funds. Preference shares may be issued as·

(i) Cumulative or non-cumulative
(ii) Participating or Non-participating
(iii) Redeemable or Non-redeemable, or as
(iv) Convertible cumulative preference shares.

In the case of cumulative preference shares, if dividend cannot be paid due to inadequate profits in a particular year the arrears of dividend will accumulate and become payable in subsequent years when profits are adequate *Non-cumulative preference shares* have no such provision.

If the shareholders, in addition to the fixed rate of dividend, are entitled to a further share in the surplus profits after a reasonable dividend has been paid to equity shareholders, the shares are known as *participating preference shares*. Where the terms of issue do not provide for it, the shares are known as *Non-participating preference shares*

Redeemable preference shares are those which the company undertakes to redeem (that is, repay) after a specified period. Where there is no such undertaking, the shares are called *irredeemable preference shares*. However, these shares can also be redeemed by the company specified period by giving notice as per th of issue.

A company may decide to issue curr preference shares with the additional pr that they will be convertible into equity the preference shares are then known as *c ible cumulative preference shares* Un present rules in India conversion of such can be decided to be made between the e years and 5 years

Merits

Issue of preference shares as a source of is preferred by many companies due to the ing reasons

(i) It helps to enlarge the sources of fi
(ii) Some financial institutions and ind prefer to invest in preference share the assurance of a fixed return.
(iii) Dividend is payable only when tl profits.
(iv) It does not affect the equity sharel control over management.
(v) The rate of preference dividend i Hence in years of prosperity the return on equity capital is likely to l higher than it would be otherwise. ' case of company A, which has Rs equity capital and Rs 10 lakhs pre capital carrying 12 p.c. dividend : the company has earned Rs.5 lakh Then Rs. 1.2 lakhs will go as pr dividend and the balance of Rs.3 will accrue to equity shareholde means the return on equity cap come to 38 p.c. against 12 p.c. or ence capital. Now take the case of c B where the entire capital of Rs ' was raised as equity capital, the return would have been only 25 p lakhs on Rs.20 lakhs investmer effect of preference share capital i as **Trading on equity** *(discussed*

	Company A		Company B	
Equity share capital	10,00,000		20,00,000	
Preference share capital @ 12%	10,00,000		Nil	
Profit earned	5,00,000		5,00,000	
Less preference dividend	1,20,000		—	
Return to equity shareholders	3,80,000		5,00,000	
Equity share capital	10,00,000		20,00,000	
Percentage return	$\frac{3,80,000}{10,00,000}$	= 38%	$\frac{5,00,000}{20,00,000}$	= 25%

Limitations

The limitations of preference shares relate to some of its main features:

(i) Dividend paid cannot be charged to the company's income as an expense; hence there is no tax saving as in the case of interest on loans.

(ii) Even though payment of dividend is not legally compulsory, if it is not paid or arrears accumulate there is an adverse effect on the company's credit

(iii) Issue of preference share does not attract many investors as the return is generally limited and does not exceed the rate of interest on loan. On the other hand, there is a risk of no dividend being paid in the event of falling income.

(b) Issue of Equity shares. The most important source of raising long-term capital for a company is the issue of equity shares. In the case of equity shares there is no promise to shareholders of a fixed dividend. But if the company is successful and the level of profit is high, equity shareholders enjoy very high returns on their investment. This feature is very attractive to many investors even though they run the risk of having no return if the profits are inadequate or there is loss Thus, the fortunes of the company are directly linked with the fortunes of equity shareholders. They bear the maximum risk and therefore, have the right of control over the management of the company At the same time, their liability is limited to the value of shares held by them.

It must be clear from the above that equity shares have three distinct characteristics:

(i) The holders of equity shares are the primary risk bearers It is the issue of equity shares that mainly provides 'risk capital'. Preference shareholders have a priority of claim on dividend and the repayment of capital, over equity shareholders Creditors' dues must be met even before any payment is made to the preference or equity shareholders

(ii) Equity shares enable much higher returns to be earned by shareholders during prosperity This is because preference shareholders are entitled to a fixed rate of dividend and loans carry a fixed rate of interest In contrast, the benefits of equity shareholders include higher dividend as well as increase in the value of the shares.

(iii) Holders of equity shares have the right of control over the company. Directors are elected on the vote of equity shareholders

Merits

From the company's point of view, there are several merits of issuing equity shares to raise long-term finance

(i) It is a source of permanent capital without any commitment of a fixed return to the shareholders The return on capital depends ultimately on the profitability of business.

(ii) It facilitates a higher rate of return to be earned with the help of borrowed funds This is possible due to two reasons. Loans carry a relatively lower rate of interest than the average rate of return on total capital. Secondly, there is tax saving as interest paid can be charged to income as an expense before tax calculation

(iii) Assets are not required to be given as security for raising equity capital Thus additional funds can be raised as loan against the security of assets.

Limitations

Although there are several advantages of issuing equity shares to raise long-term capital, there are certain limitations also of this source of finance.

(i) The risks of fluctuating returns due to changes in the level of earnings of the company do not attract many people to subscribe to equity capital. The value of shares in the market also fluctuate with changes in business conditions. This is also another risk which many investors want to avoid

(ii) Equity share capital is a permanent source of finance Once raised it cannot be refunded during the life of the company. When there is no scope for expansion or new investment during periods of economic depression, the equity capital may remain idle, the rate of return may be reduced and the value of shares may decline.

(iii) Issue of additional equity shares to raise funds for expansion poses a threat to the existing shareholders as regards their power of control over management of the company. New shareholders may exercise their voting rights against the continuation of existing directors.

(iv) Raising equity share capital beyond a certain limit is subject to government restrictions and permission has to be taken from the government to issue additional equity shares This is to prevent concentration of economic power and wealth as well as monopoly.

(v) Exclusive dependence on equity capital does not permit the company to take advantage of 'trading on equity' which may be possible in the case of debenture issue *(explained in the next section).*

2.Issue of debentures: When a company decides to raise loans from the public, the amount of loan is divided into units of equal value. These units are known as debentures A debenture is the instrument or certificate issued by a company to acknowledge its debt. Those who invest money in debentures are known as 'debenture holders'. They are creditors of the company Debentures are therefore called 'creditorship' securities. The value of each debenture is generally fixed in multiples of 10 like Rs.100, Rs.500, or Rs.1000. Debentures have two characteristics:

(a) Debentures carry a fixed rate of interest

(b) Generally debentures are repayable after a certain period which is specified at the time of issue. They may become due for repayment after a period of 5 years or more, and the period may extend upto 25 or 30 years

Depending upon the terms and conditions of issue there are different *types* of debentures.

These are:

(a) Secured or unsecured debentures

(b) Convertible or Non convertible debentures.

Debentures may be issued on the security of all or some specific assets of the company. Such debentures are known as *secured debentures* The assets are mortgaged in favour of the debenture holders. Debentures which are not secured by a charge or mortgage of any asset are called

unsecured debentures ' The holders of these debentures are treated as ordinary creditors.

Sometimes under the terms of issue debenture holders are given an option to convert their debentures into equity shares after a specified period Or the terms of issue may lay down that the whole or part of the debentures will be automatically converted into equity shares of a specified price after a certain period. Such debentures are known as *convertible debentures* If there is no mention of conversion at the time of issue the debentures are regarded as *non-convertible debentures*

Merits

Debentures issue is a widely used method of raising long-term finance by companies This is due to the following merits

(i) Interest payable on debentures can be fixed at a lower rate than the rate of return on equity shares. Thus debenture issue is a cheaper source of finance.

(ii) Interest paid can be deducted from income for tax purposes. Thereby the amount of tax payable is reduced.

(iii) Funds raised by the issue of debentures may be used in business to earn a much higher rate of return than the rate of interest As a result the equity shareholders earn more

Let us take the case of two companies. A and B having total capital of Rs 1 crore each. While company A raised the amount partly by issue of equity shares and partly by 15% debentures issue, company B raised the entire amount by issue of equity shares. Profits were subject to 50% tax in both cases. Let us see the effect of issuing debentures by company A as compared with company B which issued equity shares only.

	Company A (Rs Lakhs)	Company B (Rs Lakhs)
Equity share capital	40	100
15% debentures	60	—
	100	100
Profits before interest and taxes	39	39
Interest on debentures	9	—
Profits before tax	30	39
Tax at 50%	15	19 5
Net profits	15	19 5
Rate of return on equity capital	$\frac{15 \times 100}{40}$	$\frac{19\ 5 \times 100}{100}$
	= 37 5%	= 19 5%

It is clear that as a result of debenture issue, the rate of return on equity capital of company A was 37.5%, whereas it was only 19 5% in the case of company B. This is because company A saved Rs 4.5 lakhs in taxes as interest on debentures could be charged against profits before taxation. Besides the interest charge being fixed and deductible from income the balance of net profit accruing to equity shareholders was relatively higher as a proportion of equity capital As in the case of preference capital this is another instance of *trading on equity*

(iv) Another advantage of debenture issue is that funds are available from investors who are not entitled to have any control over the management of the company.

(v) Companies often find it convenient to raise debenture capital from financial institutions which prefer to invest in debentures rather than in shares This is due to the assurance of a fixed return and repayment after a specified period.

(vi) At times it may be easier to raise funds by debenture issue than by the issue of equity shares, for example, during depression or when the company's earning capacity is at a low level.

Limitations

We have noted above the advantages of debenture issue as a source of finance But it has certain limitations also.

(i) It involves a fixed commitment to pay interest regularly and fixed obligation to repay the amount when it is due on the part of the company. These liabilities must be discharged even if the company has low earnings The burden may be difficult to bear in times of falling profits

(ii) Debentures issue may not be possible beyond a certain limit due to the inadequacy of assets to be offered as security.

Methods of Issuing Securities

So far we have discussed various aspects of ownership securities (shares) and creditorship securities (debentures) as sources of long-term finance After deciding the amount to be raised and the type of securities to be issued the company must adopt suitable methods to offer the securities to potential investors There are four common methods followed by companies for the purpose.

(i) When securities are offered to the general public a document known as prospectus, or a notice, circular or advertisement is issued inviting the public to subscribe to the securities offered. Thereby all particulars about the company and the securities offered are made to the public. Brokers are appointed and one or more banks are authorised to collect subscription.

(ii) Sometimes the entire issue is subscribed by an organisation known as 'issue house' which in turn sells the securities to the public at a suitable time.

(iii) The company may negotiate with large investors of financial institutions who agree to take over the securities. This is known as 'private placement' of securities.

(iv) When an existing company decides to raise funds by issue of equity shares, it is required under law to offer the new shares to the existing shareholders This is described as 'right issue' of equity shares. Only if the existing shareholders decline, the new shares can be offered to the public.

Trading on Equity

We have given above two examples to show how the issue of preference shares and debentures may lead to a much higher rate of return on equity capital. *Trading on equity* refers to the positive effect on the return on equity capital of using sources of finance having a fixed charge on earnings before interest and taxes In other words, trading on equity is possible only when there is

fixed-charge financing, that is, when funds are raised by way of loan or debenture issue carrying a fixed rate of interest, or preference share issue carrying a fixed rate of dividend irrespective of the level of profits. However, there is one condition which must be satisfied before a positive effect can be expected on the rate of return on equity capital. The average rate of return before interest on total capital must be higher than the rate of return on fixed-charge finance. If this condition is not fulfilled, the available profits before interest may be inadequate even for meeting the fixed charge, not to speak of any return on equity capital.

3. Loans from financial institutions: A number of financial institutions have been set up by Government with the main object of promoting industrial development. These institutions play an important role as sources of company finance. Besides they also assist companies to raise funds from other sources. Some of the most important national level financial institutions are:

Industrial Development Bank of India (IDBI)
Industrial Finance Corporation of India (IFCI)
Industrial Credit and Investment Corporation of India (ICICI)
Industrial Reconstruction Bank of India (IRBI)

The types of financial assistance provided by these institutions are as follows:

(i) They provide medium and long term finance to industrial enterprises at a reasonable rate of interest. Thus companies may obtain direct loan from the financial institutions for expansion or modernisation of existing manufacturing units or for starting a new unit

(ii) Often, the financial institutions subscribe to the debenture issue of companies.

(iii) Some of the institutions (ICICI) and (IDBI) also subscribe to the shares issued by companies.

(iv) All such institutions underwrite the public issue of shares and debentures by companies, that is, agree to take over the securities to the extent there is no public response to the issue

(v) They guarantee loans which may be raised by industrial enterprises from other sources

(vi) Loans in foreign currency may also be granted for the import of machinery and equipments wherever necessary

(vii) The institutions stand guarantee for payments in respect of imports from abroad or purchases within the country of machinery etc. under deferred payment arrangements In other words, a company which imports or purchases machinery and has an arrangement with the suppliers to defer payment till the expiry of a certain period, may be supported by a guarantee from the institutions for the payments due to the suppliers

Apart from the national level institutions mentioned above, there are a number of similar institutions set up in different states of India. The state-level financial institutions are known as State Financial Corporations, State Industrial Development Corporations, State Industrial Investment Corporations and the like. The objectives of these institutions are similar to those of the national-level institutions But they are mainly concerned with the development of medium and small-scale industrial units. Thus smaller companies depend on the state level institutions as a source of medium and long-term finance for the expansion and modernisation of their enterprise These institutions grant direct loans as well as subscribe to the debenture issues of companies. They also guarantee loans raised from other sources and underwrite the issue of shares and debentures.

4. Retained profits: Successful companies do not distribute the whole of their profits as dividend to shareholders but reinvest a part of the profits. The amount of profit reinvested in the

business of a company is known as *retained profit.* It is shown as 'reserve' in the accounts. The surplus profits retained and reinvested may be regarded as an internal source of finance. Hence, this method of financing is known as 'self-financing'. It is also called 'ploughing back of profits'.

Since profits belongs to the shareholders, the amount of retained profit is treated as *ownership fund* It serves the purpose of medium and long-term finance The total amount of ownership capital of a company can be determined by adding the share capital and accumulated reserves.

Merits

This source of finance is considered to be better than other sources for the following reasons:

(i) As an internal source, it is more dependable than external sources It is not necessary to consider investor's preference.

(ii) Use of retained profit does not involve any cost to be incurred for raising the funds. Expenses on prospectus, advertising, etc can be avoided.

(iii) There is no fixed commitment to pay dividend on the profits reinvested. It is a part of risk capital like equity share capital.

(iv) Control over the management of the company remains unaffected as there is no addition to the number of shareholders.

(v) It does not require the security of assets which can be used for raising additional funds in the form of loan.

It is for these advantages that successful companies make use of retained profits as much as possible for expansion of business. Earnings of existing shareholders are thereby increased and the values of equity shares also go up.

Limitations

However, only well established companies can avail of this source of finance. Even for such companies retained profits cannot be used to an unlimited extent·

(i) Accumulation of reserves often attract competition in the market.

(ii) With increased earning shareholders expect a higher rate of dividend to be paid.

(iii) Growth of companies through internal financing may attract government restrictions as it leads to concentration of economic power.

5. Public deposits: An important source of medium-term finance which companies make use of happens to be 'public deposits' This requires advertisement to be issued inviting the general public to deposit their savings with the company. The period of deposit may extend up to three years. The rate of interest offered is generally higher that the interest on bank deposits. Against the deposit, a receipt is issued by the company mentioning the amount, rate of interest, time of repayment and such other information.

Public deposits are not secured loans. The depositors are like ordinary creditors. Hence, only large profitable companies enjoying public confidence are in a position to attract public deposits. Even for such companies there are rules prescribed by Government limiting its use. A company cannot accept deposits in excess of 25 p.c. of its paid-up share capital plus reserves. Out of this amount upto 10 p.c. can be from the general public. Moreover, by 30th April each year the company is required to deposit in a bank or invest in government securities at least 10 p c of the deposits to be repaid during the next financial year.

8.5.2 Sources of Short-term Finance

1. Trade credit: Trade credit is a common source of short-term finance available to all companies. It refers to the amount payable to the suppliers of raw materials, goods etc after an agreed period, which is generally less than a year It is customary for all business firms to allow credit facility to their customers in trade or business. Thus, it is an automatic source of finance. With the increase in production and corresponding purchases, the

amount due to the creditors also increases. Thereby part of the funds required for increased production is financed by the creditors. The more important advantages of trade credit as a source of short-term finance are the following:

(i) It is readily available according to the prevailing customs There is no special effort to be made to avail of it

(ii) Trade credit is a flexible source of finance. It can be easily adjusted to the changing needs for purchases

(iii) Where there is an open account for any creditor failure to pay the amounts on time due to temporary difficulties does not involve any serious consequence Creditors often adjust the time of payment in view of continued dealings.

(iv) It is an economical source of finance. While availing of the credit facility, the company foregoes a discount of 2-3 p c. which it could get on prompt payment of the bill

However, the liability on account of trade credit cannot be neglected. Payment has to be made regularly. If the company is required to accept a bill of exchange or to issue a promissory note against the credit, payment must be made on the maturity of the bill or note. It is a legal commitment and must be honoured, otherwise legal action will follow to recover the dues.

2. Bank loans and advances: Money advanced or granted as loan by commercial banks is known as *Bank Credit* Companies generally secure bank credit to meet their current operating expenses. The most common forms in which bank loans and advances may be available are *cash credit* and *overdraft* facilities. Under the cash credit arrangement the maximum limit of credit is fixed in advance on the security of goods and materials in stock or against the personal security of directors. The total amount drawn is not to exceed the limit fixed. Interest is charged on the amount actually drawn and outstanding During the period of credit, the company can draw, repay and again draw amounts within the maximum limit In the case of overdraft, the company is allowed to overdraw its current account upto the sanctioned limit. This facility is also allowed either against personal security or the security of assets. Interest is charged on the amount actually overdrawn, not on the sanctioned limit.

The advantage of bank credit as a source of short-term finance is that the amount can be adjusted according to the changing needs of finance The rate of interest on bank credit is fairly high But the burden is not excessive because it is used for short periods and is compensated by profitable use of the funds.

Commercial banks also advance money by discounting bills of exchange. A company having sold goods on credit may draw bills of exchange on the customers for their acceptance. A bill is an order in writing requiring the customer to pay the specified amount after a certain period (say 60 days or 90 days). After acceptance of the bill, the company can draw the amount as an advance from any commercial bank on payment of a discount The amount of discount which is equal to the interest for the period of the bill is deducted by the bank from the value of the bill, and the balance is available to the company. Bill discounting is thus another source of short-term finance available from the commercial banks

3. Short term loans from finance companies: Short term funds may be available from finance companies on the security of assets Some finance companies also provide funds according to the value of bills receivable or amounts due from the customers of the borrowing company, which they take over

SUMMARY

No one can think of starting business activities or running a business without adequate funds at his disposal. Larger the size of a business firm larger is the amount required While starting a business money is needed to procure various types of assets When the business is on, funds are required to meet the expenses during the production time and till money is realised on the sale of goods. Availability of finance is thus essential for ongoing activities as well as for investment in durable assets.

1. Nature and Significance of Business Finance

The importance of finance in business has increased with the growth in size of business firms. The necessity of finance also arises continuously for expansion, modernisation and introduction of new methods of production and distribution Finance plays such a vital role in modern enterprises that it is often said to be the life blood of business

2. Types of Finance

Depending on the purpose to be served, the financial requirements of a business may be distinguished as: *Long-term finance*- funds required to be invested in the business for a long period. *Short-term finance* — funds required to meet day to day operating expenses and for holding stocks of raw materials, etc., and *Medium-term finance*— funds required for a period of 2 to 5—years for particular purposes

3. Sources of Finance

The primary responsibility of financing a business venture is that of the owners of the business But loans and credits also meet the financial needs of business firms Thus for any business enterprise, there are two sources of finance, that is, funds contributed by owners called owners' funds, and funds available in the form of loans called borrowed funds

Owners' funds or *ownership capital* consist of the amounts contributed by the owners as well as their profits reinvested in the business Ownership capital is also known *risk capital*. It remains permanently invested in the business Hence a large part of it is generally used for acquiring long-lived fixed assets It is on the basis of this capital that owners have the right of control over the management of the business

Borrowed funds or *borrowed capital* include all funds available in the form of loans or credit. Loans are raised by business firms for specified periods at fixed rates of interest Thus borrowed funds may serve the purpose of long-term, medium-term or short-term finance. Borrowing involves fixed obligations to pay interest regularly and to repay the amount of loan when it is due

4. Sources of Company Finance

The sources from which a company raises financial resources may be described as (1) sources of long-term finance, and (2) sources of short-term finance. Some of these sources also serve the purpose of medium-term finance

The sources of long-term finance include

(i) Issue of preference shares and equity shares called ownership securities;
(ii) Issue of debentures (or creditorship securities) of different types,
(iii) Loans from financial institutions;
(iv) Retained profits; and
(v) Public deposits

Sources of short-term finance are·

(i) Trade Credit,

(ii) Bank loans and advances and

(iii) Short-term loans from financial institutions

The amount of capital raised by the issue of preference shares is known as *preference share capital* It carries a fixed rate of dividend to be paid if there are profits The holders of preference shares have preferential claim over dividend payment and repayment of capital in the event of liquidation of company They have no right of control over dividend payment and repayment of capital in the event of liquidation of company They have no right of control over management

The holders of equity shares are the primary risk-bearers But equity shares enable much higher returns to be earned by the shareholders during prosperity

Debenture holders are the creditors of the company A company may issue secured or unsecured debentures, redeemable or irredeemable debentures, convertible or non-convertible debentures Debentures carry a fixed rate of interest and the interest paid can be charged as an expense for tax purposes Issue of debentures enables equity shareholders to earn a much higher rate of return on their investment than it would be otherwise possible

Financial institutions at the national level provide long and medium-term loans at reasonable rates of interest They subscribe to the debenture issues of companies, and underwrite the public issue of shares and debentures. They also guarantee loans and deferred payments State-level institutions are mainly concerned with the development of medium and small scale enterprises They provide the same types of financial assistance as the national level institutions

Retained profit is an internal source of finance It is a part of the ownership capital of the company Successful companies make use of retained profits as much as possible for expansion of their business

Public deposit is a source of medium-term finance which can be raised by a company through advertisements inviting the general public to deposit their savings with the company The depositors are like ordinary creditors because public deposits are not secured loans It is only the large profitable companies which are in a position to attract public deposits The rate of interest is higher than that allowed on bank deposits.

5. Sources of Short-term Finance

Trade credit is a common source of short-term finance available to all companies It is readily available and is a flexible source *Bank loans* and advance are available in the form of cash credit and overdraft. Commercial banks also provide shor-term finance by discounting bills of exchange Loans from finance companies are generally available on the security of assets

QUESTIONS

I OBJECTIVE TYPE

Fill in the blanks·

1. Debentures are known as ________________ securities.
2. Funds required for meeting operating expenses is known as ______________ finance.
3. Long-term finance is needed for acquiring ________________

4 The financial resources of business firms consist partly of ______________ of funds and partly of ____________ funds

Which of the following statements are right and which are wrong ?

1. Public deposits can be raised by a company to an unlimited extent
2 Interest is charged by banks on the sanctioned limit of over draft
3 Trade credit is a source of medium-term finance
4. Financial institutions grant loans against security of assets
5 Participating preference shareholders participate in the management of the company.

II SHORT ANSWER TYPE

1 Explain the following terms in not more than 200 words each Medium-term finance, Convertible debentures; Trading on equity; Self-financing; Cumulative preference shares.
2. Enumerate the short-term and long-term sources of company finance.
3. What is the difference between Ownership capital and Borrowed capital ?
4. Why is equity share capital called risk capital ?
5. Name three national-level financial institutions and state their objectives.
6. What is the purpose served by short-term finance ?

III ESSAY TYPE

1 Explain the importance of finance in modern business.
2. Describe the advantages of borrowed capital as compared with those of ownership capital
3 Why do some companies prefer to raise capital by the issue of preference shares ? What are the limitations ?
4 What are the characteristics of equity shares ? What are the advantages of issuing equity shares to raise long-term finance ?
5. Describe the merits of trade credit as a source of short-term finance. Suppose a company decides to arrange bank loans and buy everything for cash, is its a good decision ? Give reasons for your answer
6 Explain the advantages of debenture issue as a source of long-term finance. What are its drawbacks ?
7 As a source of finance retained profit is better than other sources. Do you agree with this view ? Give reasons for your answer Can a company grow indefinitely by reinvesting surplus profits ?

CHAPTER 9

Stock Exchange

LEARNING OBJECTIVES

After reading this chapter, you should be able to:

1. explain the meaning and importance of a stock exchange;
2. describe the significance of listing securities;
3. analyse the various functions of stock exchanges;
4. name the recognised stock exchanges in India and state their locations;
5. enumerate the types of operators on a stock exchange;
6. distinguish between the different types of operators;
7. state the meaning of speculation;
8. describe the need for and means of regulating stock exchange operations; and
9. explain the meaning of terms used in stock exchange quotations.

9.1 INTRODUCTION

In the previous chapter we have discussed the sources of raising finance available to companies. We have explained that the two most important sources of raising long-term finance for companies are issue of shares and issue of debentures. These are known as *corporate securities* Besides registered companies, public corporations, public authorities as well as the central and state government often raise loans from the public by issuing bonds or government securities Many investors are attracted to the issue of these securities for two main advantages.

The value of units of securities are kept low (Rs.10, Rs.100, etc.) so that even individuals with small savings can subscribe to them. The second advantage is that shares, debentures, bonds and government securities can be freely transferred. Of course, it is only in the case of public companies (not in case of private companies) that shares and debentures are transferable without any restriction Thus, an investor who needs cash to meet an urgent requirement, can sell off the whole or part of the corporate securities held by him to another investor who is interested in buying them. Or, if the same investor wants to invest the amount in shares or debentures of some other company, he can purchase those securities from some other investor willing to sell the same.

We shall discuss in this chapter how the buying and selling of corporate securities are facilitated by the existence of organised markets known as *Stock Exchange, Stock Market* or *Securities market* We shall also examine the functions of stock exchanges in a modern economy, the role of different types of operators on the floor of stock exchanges, the necessity and means of regulating speculation and operations in the stock market, as well as the terms used in stock exchange quotations.

9.2 MEANING AND IMPORTANCE OF STOCK EXCHANGE

The stock exchange is an organised market for the purchase and sale of corporate securities. Such a market is located in a premises where any body who holds securities for sale can find a buyer and one who wants to buy particular securities may find a seller, both parties being assured of the transaction taking place at a fair and reasonable price The securities which may be bought and sold in a stock exchange generally include shares and debentures of public companies. These may also include government securities and bonds issued by Municipalities, Public corporations, Utility undertakings, Port trusts, and such other local authorities. Securities already issued and held by investors can only be bought and sold in the Stock Exchange. Hence such an exchange is also known as a *secondary market* for securities.

The stock exchange is generally organised by an association or body of individuals. Hence it is defined as *an association, organisation or body of individuals established for the purpose of assisting and controlling business in buying, selling and dealing in securities*

The Stock Exchange is regarded as an institution of vital importance in every country where joint stock companies are engaged in trade and industrial activities under competitive conditions. Industrial growth and development depend to a large extent on capital formation, that is, savings being invested in industrial concerns. This becomes possible on a large scale due to the existence of stock exchanges. Individuals and institutions interested in investing their savings are generally attracted towards securities issued by companies. At the same time, they want safety, liquidity and profitability of investment to be reasonably assured. They are also interested in those securities which suit their estimates of risk and return on investment.

Since buying and selling of different types of securities take place in stock exchanges, the prices of particular securities reflect their relative demand and supply. The prices of securities also indicate the financial health of individual companies. The trend of share prices over a period is regarded as an index of the financial status of industrial and trading organisations. Thus investors can take their decisions about the suitability of particular securities for *investment in terms of safety, profitability and risk Besides, they can change their decisions when necessary as liquidity of investment is provided by the easy transasferability* of securities through the stock exchanges.

The trend of security price movements on the average gives a fair indication of the state of the economy, industry and trade. That is why the stock exchange is said to be a barometer of the economic and financial health. Just as readings on a barometer reflect the atmospheric pressure and changes thereof, stock market quotations of security prices give an idea about the economic and industrial conditions.

9.3 LISTING OF SECURITIES

Securities bought and sold in a stock exchange may include shares and debentures of public companies, bonds and securities issued by government, municipalities, public corporations, and autonomous bodies like port trusts, etc. But a stock exchange does not allow transactions in securities issued by all companies. *Listing of securities means the inclusion of securities permitted to be traded in the official list of a stock exchange.* The names of companies of which securities are allowed to be traded are included in the 'official trade list' of the stock exchange. It indicates that the securities of those companies are listed by the stock exchange. Government securities do not require listing like other corporate securities

To get the securities listed for trading on a stock exchange, the company concerned has to apply in a prescribed form and submit details about its past activities, share capital, dividends paid, distribution of shares, along with copies of Directors' Reports, Balance Sheets, etc. Copies of different documents are also required to be submitted along with the application. The documents are: Memorandum and Articles of Association, and a draft prospectus complete in all particulars for approval by the stock exchange concerned.

The company must also abide by the rules and regulations which require that (i) certain prescribed clauses are included in the Articles of Association; (ii) at least 49 p.c. of the securities issued must have been offered to the public for subscription through newspapers for not less than 3 days. Further, the shares of a company cannot be listed on a stock exchange unless the following conditions are satisfied:

(i) The issued-capital is not less than Rs 50 lakhs

(ii) The public offer is not less than Rs 30 lakhs in face value

(iii) The public offer results in a wide distribution of shares among the general public without undue concentration of large holdings with the company having (a) 10 public shareholders for every Rs 1 lakh of fresh issue of capital; and (b) 20 public shareholders for every Rs. 1 lakh of offer for sale of existing capital

However, the pre-conditions laid down with regard to listing do not mean that the stock exchange stands guarantee for the financial soundness of the company, or recommends the securities to the investing public. Listing only indicates that at the time of listing, the company was legally organised, and it was till then financially solvent—as a going concern.

Even with the assurance of legality and solvency of the company, listing proves to be of particular advantage to the listed companies as

well as the investors. It creates a favourable impression about the company's credit, widens the market for its securities, and raises the value of securities The listed companies are better placed for raising funds from the public and financial institutions. For the investors, listing assures safety of dealings and the convenience of easy disposal and acquisition of securities when necessary. There is greater public confidence in listed securities as the stock exchanges compell the companies concerned to abide by rules and regulations in the interest of investors.

9.4 FUNCTIONS OF STOCK EXCHANGES

The progress of companies which control the industrial and trading activities under competitive economic conditions is ensured by the availability of adequate finance for their investment schemes. The functions performed by stock exchanges help a great deal in that respect. Certain functions are also beneficial from the point of view of the economy as a whole as well as the investing public. Let us examine the more important functions.

(i) The stock exchange *provides a ready market* which is continuously available for conversion of existing securities into cash and vice versa. With easy marketability of securities there is improved liquidity of investible funds. This encourages investment of savings in the capital of industrial enterprises. Easy marketability of shares and other securities increases their value as security against loans to be raised from banks or financial institutions. The lender is able to know the worth of the security from the prices of shares quoted in the stock exchange.

(ii) The stock exchange *provides appropriate conditions* whereby the purchase and sale of securities take place at a reasonable and fair price. The prices at which bargains are made between willing buyers and sellers are recorded and made public. On the basis of these prices or market quotations every investor is able to evaluate the securities held by him and thus knows the worth of his holdings at any time. He is also able to estimate the amount he can borrow on the security of his holdings

(iii) Another function of stock exchanges is to protect *the interest of investors* through strict enforcement of the rules and regulations with respect to dealings. The possibility of innocent investors being deceived by brokers is prevented in an organised stock exchange. The membership of brokers is subject to the rules which provide for punishment including suspension, fine or even expulsion of members if they adopt any malpractice in their dealings with investors, like charging an excessively high commission, etc.

(iv) *The management and working of companies are influenced* to a great extent by stock exchanges in public interest. Every company which wants its securities to be quoted and traded on a stock exchange has to submit itself to the rules framed by the exchange in that respect. It is through these rules that a stock exchange protects public interest. For example a listed company cannot discriminate between investors while making allotment of shares issued for public subscription.

(v) The stock exchange *ensures investible funds* or capital to flow into the most profitable enterprises. Relatively prosperous companies can raise capital more easily because investors are more attracted towards their securities. The prices of existing securities are often quoted above the face value which indicates good prospects for the enterprise. On the other hand, the securities of relatively less profitable are quoted at lower price. The investors sell such securities in favour of the securities of more profitable concerns.

(vi) The stock exchanges *play an active role in encouraging people to invest* their savings in industrial and government securities. This is due to the publicity given by exchanges about various types of securities being traded alongwith their

prices. Thus, the stock exchanges create the habit of saving, investment and risk taking among the general public. The attractiveness of investment in securities leads to increased capital formation in the country. The funds available to the companies and the government meet their capital requirements.

(vii) With the facilities provided by stock exchanges for buying and selling securities, the *demand and supply of particular securities are equalised* and price fluctuations are kept within reasonable limits. People who expect a rise in the price of securities buy them in advance to make a profit when the prices go up as expected. The purchase of such securities in advance raises the price immediately and the future price rise is not as high as it would be otherwise. Similarly, if prices are expected to fall in the near future, people may sell the securities now when prices are high With increased supply of securities now, the higher prices tend to fall, and the future decline is not very sharp. As a result of this type of dealing price movements become smoother. These are known as speculative dealings *(discussed later in this chapter)*.

9.5 STOCK EXCHANGES IN INDIA

There are 14 recognised stock exchanges in India located in the following cities:

Ahmedabad,	Hyderabad,
Bangalore,	Indore,
Bombay,	Jaipur,
Calcutta,	Kanpur,
Cochin,	Ludhiana,
Delhi,	Madras,
Guwahati,	Pune.

All these exchanges are recognised by the Government of India under the provisions of the Securities Contract (Regulation) Act, 1956. Some of these exchanges, like those in Bombay, Ahmedabad and Indore, are organised as voluntary associations, those in Calcutta and Delhi as public limited companies, and those in Hyderabad, Madras and Bangalore, as guarantee companies

9.6 SPECULATION OR SPECULATIVE ACTIVITY

Speculative activity or speculation on a stock exchange refers to the buying and selling of securities in the hope of a profit from anticipated changes in the price of securities. Those who engage in such activity are known as 'speculators' A speculator may buy securities in anticipation of rise in price. If his expectation comes true he sells the securities at a higher price and makes a profit. On the other hand, he may be disappointed if his expectation does not come true, and prices do not rise In that case he will suffer a loss Similarly, a speculator may expect prices to fall and sell securities at the current high price, to buy again when prices decline. He will make a profit if prices decline as expected. Otherwise he will suffer loss

Usually the speculator does not take delivery of the securities purchased by him. Similarly he does not actually deliver the securities sold by him. He only receives or pays the difference between the purchase and sale prices, as the case may be. Let us take the following example. Suppose, a speculator has agreed to buy 100 shares at Rs.25 each after a month. When the time comes for settlement of the transaction, the actual price of the shares is Rs.26 each. The speculator will not buy the shares at Rs.25 and sell them at Rs.26. Instead he would ask the other party to pay him the difference at the rate of Re.1 per share He would thus earn Rs.100 on 100 shares without taking or giving delivery of the shares. Thus, the primary object of speculation is to gain from future changes in the price of securities. Thus, speculation may be regarded as a risky activity. If the change in price does not take place as expected, the speculator is put to a loss.

9.6.1 Benefits of Speculation

The following benefits may be said to arise out of speculative activities

(i) It leads to smoother change and prevents wide fluctuations in security prices. Speculators buy in anticipation of rise in prices. This creates additional demand for securities and raises the current low prices. The sale of securities in future prevents their prices going up very high. Similarly, sale in anticipation of a decline in prices leads to keeping down the prevailing high prices The corresponding purchases made when prices tend to decline keep up the prices.

(ii) Speculators also prevent wide fluctuations in security prices at different places If certain security is selling at a higher price in one market, the speculators buy the same from other markets and sell in that market. Thereby the supply and demand are equalised in different markets, and price movements are not very wide.

(iii) Speculative activities and the resulting effect on the prices of securities provide a guidance to the public about the market situation. This is because speculators generally act on the basis of intelligent analysis of market trends and other factors.

9.6.2 Difference between Investors and Speculators

Generally speaking, investors are those who purchase securities to earn income by way of dividends and interest and those who sell securities they hold for ready cash On the other hand, speculators are those who buy securities with the hope of selling them in future at a profit, and those who sell with the expectation of buying them at a profit in future Their intention is to make profit through difference in prices. The investors and speculators in the stock markets may be distinguished as follows:

INVESTORS	SPECULATORS
(1) An investor is interested mainly in the safety of investment, regularity of income, and appreciation in the value of securities	The speculator's main interest is in making quick profits on the basis of price changes
(2) The investor takes delivery of the securities and pays for them after purchase, and delivers the securities which he has sold on payment	The speculator does not take delivery of the securities purchased, or gives delivery of securities sold by him He receives or pays the amount of difference in the sale and purchase prices.

9.6.3 Difference between Speculation and Gambling

Speculation and gambling operations appear to be the same. In both cases, the profits or losses depend upon future events which are uncertain. The object of speculation as well as gambling is to make quick profits. However, there are also certain differences between the two types of activities

(i) Speculative activities are undertaken on the basis of intelligent study and analysis of market trends and other factors influencing the prices of securities. It is based on knowledge and foresight of anticipated change in prices. Gambling is *not* based on any intelligent analysis of factors influencing the market trend It is based on the chance of events happening, and not on scientific facts or reasoning.

(ii) The gambler's agreement is void and not enforceable in any court of law. Speculation is a lawful activity and is enforceable at law.

(iii) While speculation performs certain economic functions *(explained earlier)*, gambling has no benefits to offer to the economy as a whole. That is why gambling is regarded as anti-social and illegal, while speculation is considered useful in stock exchange operations.

(iv) The speculator bears the risk of loss on the basis of logical reasoning. His activity takes care of the existing risk of price fluctuations On the other hand, gamblers assume risks of loss on the basis of blind and reckless expectations, which create an artificial risk of loss

Inspite of these differences, speculation may sometimes take the form of gambling if the speculator acts recklessly and blindly without applying his mind or intelligence and without possessing funds to meet his commitments. In that case, speculation is said to have degenerated into gambling.

9.7 TYPES OF OPERATORS

Transaction of business on a stock exchange is allowed to be undertaken only by members of the exchange. Ordinarily none except a member is allowed to enter the premises of the stock exchange Thus, every stock exchange has its own regulations regarding the admission of members. Indeed, membership is restricted to persons who have sound financial position and possess enough experience.

There are two broad categories of members who transact business on the stock exchange: (i) *Broker*, and (ii) *Jobber*.

(i) Broker: *A broker is a commission agent who transacts business in securities on behalf of non-members.* He works for commission and acts for a large number of clients, thus dealing in a variety of securities. The services of a broker is extremely useful to the ordinary investor who does not have the necessary skill or expertise for the purpose of buying or selling securities

(ii) Jobber: *A jobber is an independent dealer in securities.* He can purchase and sell securities directly and can deal with a broker or another jobber. He is a 'dealer' in his own right. He is a professional speculator and usually specialises in buying and selling a limited number of securities. He works for profit rather than on a commission basis The profit earned by a jobber is known as the 'jobber's turn'. Like the broker, a jobber also renders useful service to the investors by executing orders without delay. This helps to prevent wide fluctuation in prices, and to make it smooth. With his specialised knowledge and experience, a jobber is able to determine the price at which any security should be bought or sold. Jobbers provide continuity of operations on the stock exchange and thus help to stabilise prices.

In India, there is no clear-cut distinction made between jobbers and brokers. Due to insufficiency of business, a member can act as a broker or jobber or both. However, functionally the operations of brokers and jobber differ.

DIFFERENCE BETWEEN BROKERS AND JOBBERS

	Broker	*Jobber*
(a)	Transacts business as a commission agent on behalf of non-members or other members	Transacts business on his own right Works for profit.
(b)	The rate of commission is fixed.	The jobber's turn or profit is not fixed It can be any amount.
(c)	A broker can transact business for his clients only through a jobber	A jobber can deal with a broker or another jobber.
(d)	The brokers act as a link between the investing public and the jobbers They protect the interest of investors by forming a ring fence round the jobbers.	The jobbers transact business directly with brokers and other jobbers

Tarawaniwalas: In Bombay stock exchange, the members are unofficially classified into two categories: *Commission Brokers* and *Tarawaniwalas*. Literally speaking, the word 'tarawaniwala' means one who takes away the cream of the business. Like the jobber, a tarawaniwala is a dealer in securities who transacts business in his own name and on his own behalf. Usually he specialises in one or two securities. While operating as a dealer, the tarwaniwalas are also permitted to act as brokers Thus any tarawaniwala could purchase securities from his clients at lower prices, or sell his own holding to them at a higher price Hence, to safeguard the interest of investors it is provided under the Securities Contracts (Regulation) Act, that a member of any recognised stock exchange cannot transact business as principal. If he intends to do business as principal with a non-member, he must get the authority or consent of the person and disclose in the agreement that he is acting as principal.

Authorised Clerks and Remisiers: As we have stated earlier, none but members are generally allowed to transact business on a stock exchange. However, some other persons are also allowed to transact business on behalf of members for the convenience of operations. They are: *Authorised Clerks* and *Remisiers*.

Authorised Clerks: When any member is unable to cope with the business in hand, stock exchanges permit him to employ clerks and assistants for help. Known as *authorised clerks*, they are permitted to transact business on behalf of their employer. They can sign on behalf of the member only when they carry a power of attorney from him. But they cannot make any bargain in their own name.

Remisiers: In the Bombay Stock Exchange members are entitled to appoint agents to secure business for them. These agents are known as *remisiers*. A part of the commission earned by the members is paid out to the remisiers on the business secured by them. They are also known as *half commission agents* because their commission cannot exceed 40 p.c. of the commission earned by members concerned.

9.8 TYPES OF SPECULATORS

Members who engage in speculation on the stock exchanges are given different names according to the nature of their speculative activity. Although there are a number of different types of speculators, two main categories are (i) *Bulls*, and (ii) *Bears*

(i) Bull: Those who expect a rise in the price of certain securities and act on that basis are known as "Bull" speculators A bull buys securities in anticipation of a price rise (without taking actual delivery) and sell the same in future at the higher price. He is an optimist, that is, strongly hopes that the price will go up. A "Bull" speculator is so called because the bull is mostly found to throw its victim up in the air. Just like the bull, a "Bull" speculator expects and often tries to push the prices up. He is also known as *tejiwala*.

When buyers are more active than sellers of securities, it is known as 'bullishness' of the market, and the market as a 'bull market'. Let us take an example of bull speculation. A speculator instructs his broker to buy for him 1000 shares of a company at Rs.10 each. There is no need for payment or receiving delivery of the shares at the time of the deal. Suppose on the date of settlement of the transaction, the price has gone up to Rs. 11 per share, the speculator will at once ask the broker to sell the shares. It is again not a sale in the real sense. The settlement of the deal takes place by the speculator receiving the amount of profit, that is, the difference between the buying and selling prices as follows:

Sale price of 1000 shares		
@ Rs. 11 each	:	Rs. 11,000
(—) purchase price		
@ Rs. 10 each	:	10,000
Profit earned		Rs. 1,000

If the price falls against the expectation, or it does not rise, the bull speculator suffers a loss. But he has also the option to carry forward the settlement to the next settlement day. For this purpose he has to pay a charge, which is known as *contango* He does this if he still expects the price to go up, and provided the price rise is such that he may cover the contango as well as make some profit. In fact, if bulls become very active, the buying pressure may actually raise the price.

(ii) Bear: A bear speculator is one who anticipates fall in the price of particular securities. He is also known as 'mandiwala' in the Bombay Stock Exchange. Since in the animal world, the bear has a tendency to press its victim downwards, speculators who try to press down the prices are known as *Bears*. A bear sells securities to take advantage of the expected fall in price by buying at a lower price against the earlier sale at a higher price In this case too, the selling and buying transactions are not undertaken in the real sense. If the price actually declines by the time settlement is due, the speculator gets the difference between the selling and buying prices, which is his profit.

If sellers are more active in a market, it is known as "bearishness of the market" and the market as a 'bearish market'. Let us take an example of bear speculation. A speculator expects a fall in the price of shares of a company, and sells 500 shares at Rs. 15 each. Suppose on the settlement day, the price has dropped to Rs. 12 per share. The speculator will then make a deal to buy 500 shares. The sale and purchase will be settled by payment of the speculator's profit at Rs. 3 per share by the other party. However, if the price does not fall or rises by the date of settlement, the bear speculator suffers a loss. But he is entitled to carry forward the settlement to the next settlement day. He can do so by paying a charge known as *backwardation*, if he still expects the price to decline so as to enable him cover the backwardation charge and make a profit. Actually the selling pressure generated by bears may bring down the price and the purpose of speculation is served.

9.9 SPECULATION AND REGULATION OF STOCK EXCHANGES

We have discussed earlier how certain benefits flow from speculative activities. The benefits arise mainly because such activities are based on intelligent study and analysis of factors which influence the market trend of prices of different securities. To be of use, it is also necessary that speculators must have adequate funds at their disposal to discharge their commitments relating to the transactions they undertake. When speculative activities are undertaken with these conditions satisfied, it is known as 'legitimate speculation' and those engaging in it are known as 'genuine speculators'. If people engage in speculation blindly and recklessly without having the necessary skill and knowledge or having adequate funds, it degenerates into gambling. Those who gamble not only bring about their own ruin because they are not capable of bearing losses, but those who transact business with them sooner or later become financially bankrupt.

Excessive speculation is also harmful to the investing public. In a bullish market, security prices often go up very high due to the buying pressure of bulls. Many investors are attracted by it and the bull market becomes all the more active. But the artificially raised price cannot be sustained for long Sooner or later there is a crash, and a sharp all-round decline in prices which continues to intensify. As a result, many who had purchased certain securities with the hope of selling at a higher price, suffer heavy losses. With the share values declining, many companies are on the verge of liquidation. In this process, stock market speculation, instead of stabilising the prices of securities, leads to periodic booms and slumps.

Besides the above effects of speculation, a number of unfair practices and undesirable activi-

ties go in the name of speculation. Some of these malpractices are mentioned below:

(i) Wash sales: Wash sales refer to fictitious transactions in which some speculators sell particular securities and then buy the same at a higher price through some other brokers. This creates false and misleading opinions in the market about the price of securities. As a result the price records further rise and the broker-speculator is able to reap profits by selling his holdings to the public.

(ii) Cornering: This refers to a situation in the stock market in which almost the entire supply of a particular security is held by an individual or group. This creates a problem for bear-speculators who agreed to sell securities but did not possess the same. They would be unable to fulfill their commitment to the buyers who have cornered the securities. The bears will have no other alternative but to agree to the terms dictated by the buyers.

(iii) Rigging: In a bullish market, the buyers may artificially force up the price of certain securities. Those who hold large blocks of shares buy and sell their holdings to have a control over the market quotations, and then start selling (unloading) the shares gradually. This prevents free interplay of demand and supply. Such undesirable operations by speculators are known as 'rigging the market'.

(iv) Blank transfer: When shares are sold by an operator to another person, there is an agreement of transfer (transfer deed) to be signed by both the parties. This enables the buyer to register the transfer with the company. Thereby the name of the transferee (buyer) is recorded in the Register of Members of the company in place of the transferor (seller). When the name of the buyer is not mentioned in the transfer deed, and the seller only signs it is known as *Blank Transfer*. In that case, transfer could take place a number of times without payment of stamp duty, which is required to be paid for registration with the company. The practice of blank transfer does not require registration of temporary purchase and sale of shares, and encourage speculation. Several other undesirable consequences follow. Since the name of the transferee is not disclosed, he can evade income-tax. Successive buyers do not have to pay the stamp duty. The transferees can control the management of companies without their names being disclosed. If the shares are partly paid-up, the transferors (sellers) remain liable for paying the uncalled portion for an indefinite period

9.9.1 Regulation of Stock Exchange Operations

Due to the necessity of regulating and discouraging the malpractices and undesirable consequences flowing from speculative activities, the Government of India has powers of control over all stock exchanges provided under the Securities Contracts (Regulation) Act. Some of the more important regulatory provisions of the Act are outlined below:

(i) Recognition of stock exchanges: Every stock exchange must secure recognition from the Central Government before it starts functioning Before recognition is granted, the Central government has to satisfy itself about certain conditions being fulfilled, such as: (a) the rules and bye-laws of the exchange ensure fair dealing to the investors and protect the interest of the investing public; (b) the exchange will act according to any condition that may be laid down by government from time to time; (c) it is in the interest of the investing public, trade and industry that the stock exchange needs to be recognised.

(ii) Central government control: The Act contains several provisions to secure the working of stock exchange controlled by the Central Government. The exchanges are required to submit periodical returns about their affairs to the government, and supply all information and explanation that may be asked for by the government. A copy of the annual report of every exchange must be submitted to the government. The

Central Government is also empowered to order an enquiry into the affairs of a recognised stock exchange whenever necessary, and also direct the exchange to adopt or amend any rule.

(iii) Government powers to regulate the working of stock exchanges. Under the provisions of the Act, the Central Government has powers to regulate the following aspects of operations on a stock exchange:

— Hours of trading on a stock exchange;
— Regulation of blank transfer and carry over facilities;
— Regulation of *tarawani* business;
— Fixation of the rates of brokerage (commission), fines, fees and penalties for default or violation of rules;
— Settlement of claims or disputes by arbitration.

(iv) Control over speculation and regulation of undesirable activities: The following measures of control over speculation and other undesirable activities are provided for in the Securities Act or the bye-laws and rules of stock exchanges:

(i) Although blank transfer is not prohibited, it is discouraged by the Act which lays down that the transferee under such a transfer will not be entitled to the dividend on the shares acquired unless the transfer is registered with the company within 15 days of the date on which dividend became due. In this connection, the Companies Act has laid down as follows: Transfer of shares shall be made in prescribed form and presented to the Registrar of Companies, before it is signed by the transfer, for endorsement of the date of presentation The transfer deed is then to be delivered to the company for registration of the transfer. This must be done, in the case of listed securities, before the first closing of the Register of Members after the date of presentation, and in the case of unlisted securities, within two months after the date of presentation.

(ii) Undesirable practices like wash sales, cornering, rigging, etc. attract severe penalties under the bye-laws of most recognised stock exchanges.

9.10 TERMS USED IN STOCK EXCHANGE QUOTATIONS

When prices are quoted in connection with stock exchange deals and in the process of bargaining between buyers and sellers, different terms are used, some of which are briefly explained below

(i) Spot delivery It refers to a transaction or contract in which the parties agree to take delivery and pay for the securities. A spot delivery contract is expected to be settled on the same day or within a short period of time, usually a week.

(ii) Forward delivery The term refers to contracts in which the transactions are expected to be settled on fixed settlement days occurring at fortnightly intervals. If the parties so agree, the date of settlement can be postponed by carry over the deal from one settlement day to the next.

(iii) Ex-dividend (or Ex-div): The prices of securities bought and sold are sometimes quoted 'ex-dividend' or 'ex-div.' It means that the buyer agrees to acquire the shares without the right to receive dividends, if any, declared by the company. The ex-dividend price paid does not include the amount of dividend which the company may declare. If the company has declared that the Share Registers have been closed, or will be closed on a certain date and the buyer cannot get his name registered in time, the shares are generally acquired at ex-dividend price.

(iv) Cum-dividend (or Cum-div.): Share prices are quoted Cum-dividend (or cum-div.) When the buyer of shares acquires the right to receive the amount of dividend declared by the company but not yet paid. The price paid includes the dividend receivable, and is therefore higher than the price which would have been paid otherwise.

SUMMARY

1. Stock Exchange

Stock Exchange is an organised market for the purchase and sale of securities. It is defined as an association, organisation or body of individuals established for the purpose of assisting and controlling business in buying, selling and dealing in securities.

2. Role of Stock Exchange

The *role of stock exchanges* in a competitive economy is of vital importance because they help the industrial growth and development which depend on capital formation. Stock exchanges encourage savings and investment by the public by providing safety, liquidity, and profitability of investment in securities

3. Listing of Securities

Listing of securities refers to the inclusion of securities in the official list of securities which are permitted to be traded on a stock exchange.

4. Functions of Stock Exchange

The more important *functions of a stock exchange* are as follows:

(i) It *provides a ready market* and facilitates easy marketability of securities.

(ii) It *ensures appropriate conditions* for purchase and sale of securities to take place at fair and reasonable price.

(iii) It *protects the interest of investors* through strict enforcement of rules and regulations with respect to dealings.

(iv) *Management of companies are influenced* to a great extent by stock exchanges in the public interest.

(v) It *ensures investible* funds or capital to flow into the most profitable enterprises.

(vi) The stock exchange *encourages savings and investment* by the publicity given about different types of securities being traded along with the price quotations.

(vii) The demand and supply of particular securities are *equalised* and price fluctuations *kept within limits* due to the facilities provided by the stock exchange for buying and selling securities.

5. Stock Exchanges in the Country

There are 14 *recognised stock exchanges* in India located at: Ahmedabad, Bangalore, Bombay, Calcutta, Cochin, Delhi, Guwahati, Hyderabad, Indore, Jaipur, Kanpur, Ludhiana, Madras, Pune. Some of these exchanges are voluntary associations, some are public limited companies, and some are companies limited by guarantee.

6. Speculation

Speculation or speculative activity on a stock exchange refers to the buying and selling of securities in the hope of a profit from anticipated changes in their prices. Those who engage in such activities are known as speculators.

Usually the speculator does not take delivery of the securities purchased by him. Nor is delivery given on sale of securities. The *speculator only receives or pays the difference* between the purchase and sale prices as the case may be

The *benefits of speculation* are as follows

(a) It leads to smoother change and prevents wide fluctuations of security prices.

(b) Wide fluctuations in security prices are also prevented at different places by the act of speculators.

(c) The resulting effect of speculation on security prices provides a guidance to the public about the market situation.

7. Investors

Generally speaking, *investors* are those who purchase securities to earn income by way of dividends and interest, and sell securities they hold for ready cash. *Speculators* are those who buy or sell securities to earn profit from anticipated changes in the prices thereof

8. Speculation and Gambling

Speculation and *gambling* appear to be the same, but there are certain differences between the two types of activities. (i) Speculation is based on knowledge and foresight. Gambling is based on chance of events happening. *(ii)* Gambling is illegal. Speculation is a lawful activity. (iii) Speculation performs certain economic functions. Gambling has no benefits to offer to the economy. (iv) Speculators bear the risk of loss on the basis of logical reasoning. Gamblers assume risks of loss on the basis of blind and reckless expectations.

9. Broker, Jobber and Tarawaniwala

There are two broad categories of members who transact business on the stock exchange: (i) Broker, and (ii) Jobber. A *broker* is a commission agent who transacts business with non-members or other members He acts for commission and deals with a large number of clients A *jobber* is an independent dealer. He can purchase and sell securities directly and can deal with a broker or another jobber. He is a dealer in his own right

A *Tarawaniwala*, like the jobber, is a dealer in securities who transacts business in his own name and on his own behalf. He can also act as a broker.

10. Authorised Clerks & Remisiers

When any member is unable to cope with his business alone, he is permitted by the stock exchange to employ clerks and assistants for help Known as *authorised clerks*, they transact business on behalf of their employer. *Remisiers* are agents of members. They are appointed to secure business for the members and earn a part of the commission on the business secured.

11. Types of Speculators

Speculators are given different names according to the nature of their speculative activity. Two main types of speculators are: *Bulls* and *Bears* A 'bull' speculator buys securities in anticipation of a price rise (without taking actual delivery) and sell the same in future at a higher price He is also known as "tejiwala". If his expectation comes true, he makes profit. If the price falls or does not rise, the bull speculator suffers loss But he has also the option to carry forward the deal to the next settlement day. For this purpose he has to pay a charge known as 'contango'.

A 'bear' speculator is one who sells securities in anticipation of a fall in the price If the expectation comes true, he buys at a lower price against his earlier sale at a higher price and makes a profit. He is also known as "mandiwala" in the Bombay Stock Exchange However, if the price does not fall or rises, the speculator suffers a loss. To avoid it, he may carry forward the transaction to the next settlement day on payment of a charge known as 'backwardation'.

12. Effects of Speculation

Often speculation leads to harmful effects and is associated with malpractices of different kinds. It degenerates into gambling when speculators act blindly or do not possess the necessary skill and knowledge, or they do not have adequate funds to meet their commitments Excessive speculation may lead to periodic booms and slumps instead to stability of security prices. Malpractices and undesirable activities of speculation include wash sales, cornering, rigging, blank transfer, etc.

13. Regulation of Stock Exchange

Some of the more important provisions of the Securities Contracts (Regulation) Act to regulate stock exchange operations relate to

(i) Recognition of stock exchange,
(ii) Central government control over stock exchanges;
(iii) Government powers to regulate the working of stock exchanges,
(iv) Control over speculation and regulation of undesirable activities under the bye-laws of exchanges

14. Terms Used in Stock Exchange Quotations

Some of the terms used in connection with stock exchange price quotations are:

Spot delivery · Contracts in which the parties agree to take delivery and pay for the securities within short period, usually a week

Forward delivery. Contracts in which transactions are expected to be settled on fixed settlement days occurring at fortnightly intervals

Ex-dividend quotation means that the buyer agrees to acquire the shares without the right to receive the dividend, if any, declared by the company.

Cum-dividend price is quoted when the buyer of shares acquires the right to receive the amount of dividend declared by the company but not yet paid.

QUESTIONS

I. OBJECTIVE TYPE QUESTIONS

Match the expressions in columns A and B by pairing the serial numbers and alphabets:

	Column A		*Column B*
(i)	Purchase in anticipation of rise in prices	(a)	Bear
(ii)	Fixed commission	(b)	Carry over
(iii)	Independent dealer	(c)	Broker
(iv)	Selling in anticipation of fall in price	(d)	Bull
(v)	Postponing the settlement	(e)	Tarawaniwala

Which of the following statements are right and which are wrong?

1. There is no difference between speculation and gambling
2 The bull speculators always make profit and bear speculators always suffer loss
3 Brokers deal in a large number of different securities.

4 Blank transfer is discouraged but not prohibited
5 A jobber can deal with only other jobbers.

Fill in the blanks

(1) A broker can transact business for his clients only through ____________.
(2) Profits earned by jobbers are known as ____________.
(3) Stock exchanges protect the interest of ____________.
(4) A jobber is a ____________ speculator.
(5) Wash sales are ____________ transactions.
(6) The stock exchange is regarded as a ____________ of economic and industrial health

II. SHORT-ANSWER TYPE QUESTIONS

1. Define a stock exchange
2. Name the location of at least five recognised stock exchanges
3. What do you understand by speculation ? Briefly state the benefits of speculation.
4. State briefly the difference between :
   (i) Speculation and gambling;
   (ii) Speculator and investor.
5. Briefly explain with an example the nature of
   (i) Bull speculation;
   (ii) Bear speculation.
6. Distinguish between (a) Broker and Jobber,
   (b) Ex-div., and Cum-div quotations

III ESSAY TYPE QUESTIONS

1. Explain the nature of speculative activities of bulls and bears. What are the benefits of speculation ?
2. Discuss the importance of stock exchanges in a competitive economy What are their functions ?
3. What are the evils of speculation ? How are these regulated ?
4. Explain what is meant by 'Listing of securities'. What are the conditions to be satisfied by a company for listing of shares ?

CHAPTER 10

Internal Trade

LEARNING OBJECTIVES

After reading this chapter, you should be able to.

1. explain the meaning and types of internal trade;
2. describe the functions of wholesale trade;
3. discuss the functions and services of retailers;
4. enumerate the types of retail organisations,
5. recognise the characteristics of retail organisations.

10.1 INTRODUCTION

Trade is an important part of commerce It refers to the sale, transfer or exchange of goods and services for a certain price. Exchange of goods and services, therefore is the basis of trade.

Trade can be classified into two broad categories as follows:

(i) Internal trade
(ii) External trade.

10.2 INTERNAL OR HOME TRADE

When buying and selling of goods and services takes place within a country, it is referred to as internal trade or home trade Some of the important features of such trade are:

(i) all payments are made in the national currency;
(ii) generally there are no restrictions on the movement of goods; and
(iii) several alternative modes of transport are available for carrying goods

On the basis of the scale of operations, internal trade can be broadly sub-divided into two categories:

(i) Wholesale trade
(ii) Retail trade

10.3 WHOLESALE TRADE

Wholesale trade consists of buying goods directly from the producers or manufacturers and selling them to retailers in relatively small quantities. Wholesalers are those businessmen who buy and resell merchandise to retailers and other firms but do not generally supply goods to the ultimate consumers. They generally deal in a particular line of goods like textiles, paper, food grains, etc. They provide a vital link between producers and retailers. In other words, wholesalers act as middle-men or intermediaries in the distribution of goods and services.

10.3.1 Types of Wholesalers

Depending upon their activities, we may classify wholesalers into three types, namely:

(i) Manufacturer wholesalers;
(ii) Retailer wholesalers; and
(iii) Pure wholesalers

(i) Manufacturer wholesalers: These wholesalers undertake manufacture of goods as well as their distribution directly to retailers. They usually do not deal in goods manufactured by other firms. By combining the activities of manufacturing and distribution, they are in a position to minimise their overhead expenses on transportation, warehousing etc

(ii) Retailer wholesalers A retailer wholesaler is one who, besides selling goods to retailers also deals directly with the ultimate consumers. In this way he is able to establish direct contact with the consumers so as to get prompt information relating to their preferences. Besides, it enables him to reduce the distribution costs and increase his margin of profit

(iii) Pure wholesalers: Pure wholesalers concentrate on buying from other producers or distributors and selling only to the retailers. They do not engage in production or direct sale to consumers. Such a wholesaler is thus able to better serve the manufacturers as well as retailers.

10.3.2 Functions of Wholesalers

As stated earlier, the wholesaler acts as an important link in the chain of distribution of goods between the producer and the ultimate consumer. As an intermediary, he performs a number of functions. These are outlined below.

(i) Assembling of goods Wholesalers procure goods from different manufacturers and collect the same at one place They maintain adequate stock of these goods so that they are

available to the retailers as and when required.

(ii) Physical distribution Wholesalers help in physically moving the goods as well as the transfer of ownership from producers to the retailers. The retailers in turn transfer the same to the ultimate consumer or users.

(iii) Breaking the bulk: Breaking the bulk refers to the task of dividing larger quantities into smaller lots. Wholesalers perform this function by buying goods in large quantities and selling them in relatively smaller quantities

(iv) Storage: Wholesalers arrange for the storage of goods till they are sold to the retailer. To that extent they relieve the manufacturers and retailers of the burden of holding large stocks and providing storage space for the same.

(v) Grading and packaging: Wholesalers sort out the various products according to their quality and certain standards This function is known as grading. On the basis of grading, goods are then packed in convenient lots so that they can be sold to the retailers and other users.

(vi) Financing: The wholesalers generally purchase goods from the producers on cash basis and advance money to producers against big orders. They also extend credit facilities to retailers

(vii) Risk of distribution. Till the time goods are sold, wholesalers bear the risks of distribution, which may occur due to spoilage or damage of goods, changes in demand and prices, etc

(viii) Stimulation of demand. Wholesalers also assist in the dispersal of goods by undertaking various activities like advertising, personal selling, and sales promotion. This goes a long way in increasing the demand for goods produced.

10.3.3 Services of Wholesalers

The functions described above suggest that the wholesalers render various services to the manufacturers and retailers. Some of the important services are described below:

Services to manufacturers

(i) Economies of scale: The wholesalers collect small orders from retailers and procures in bulk from the manufacturers. This enables goods to be produced on a large scale and cost of production to be minimised.

(ii) Marketing information: The wholesalers collect important marketing information with respect to changes in demand, competition etc. from the retailers who are in direct touch with the consumers. Such information is then passed on to the manufacturers, which makes it possible for them to develop plans for the marketing of their goods

(iii) Help in distribution: The wholesalers help in distributing goods of different producers through retailers for the use of ultimate consumers Manufacturers are thereby able to reach customers scattered over different geographical regions.

(iv) Warehousing: Since wholesalers generally have to maintain large stocks of goods, the manufacturers are not required to arrange storage facilities of their own. This reduces their total cost of operation.

(v) Financial support The wholesalers provide financial assistance by making advances to manufacturers specially when they place orders for bulk supply of goods.

(vi) Concentration on production Since wholesalers take care of the distribution of goods, the producers are relieved of their marketing responsibilities. This enables them to concentrate more on manufacturing activities.

(vii) Regular supply of products. Goods produced by different manufacturers are usually held in stock by the wholesalers. This helps in maintaining regular supply of the goods, specially during periods of increased demand. It also helps in stabilising the prices of the products

Services to Retailers

(i) Sources of ready supply A retailer is required to maintain stock of a large variety of goods in sufficient quantity, to satisfy varying needs of the customers But it may not be practicable for him to collect such a variety from different manufacturers directly. Wholesalers, help him in this regard by providing different varieties of goods in small quantity as and when required

(ii) Warehousing In order to maintain large stocks of goods at all times, wholesalers have to provide for warehousing facilities for the goods. This relieves the retailers of the need for holding large stocks and making storage arrangements for the same

(iii) Financing Wholesalers supply goods to the retailers on credit. The retailers generally pay back when their own customers clear their dues This facilitates the retail business to be carried on with a relatively smaller amount of working capital.

(iv) Assumption of risk· Retailers need not assume the risks in respect of spoilage or damage of goods, or risks of loss on account of changing demand, as they do not have to maintain large stock of goods at all times All such risks are borne by the wholesalers

(v) Advice to retailers· By virtue of their experience in the trade, wholesalers are more informed about different products in the market. They are in a position to advise the retailer on important matters, such as quality, durability, price and timings of purchase. They also give information about the new products entering the market.

10.4 RETAIL TRADE

Retail trade is concerned with the distribution of goods to the ultimate consumers or users. It involves buying from wholesalers or manufacturers and selling directly to the ultimate consumers. Sometimes, manufacturers and wholesalers sell goods to the ultimate consumers Thus, they may be regarded as engaged in retailing business However, retail trade is mostly carried on by retailers (those who run small shops or stores) who neither manufacture goods nor undertake wholesale business.

The business of a retailer is usually local in character. But he has to maintain stock of a variety of goods, in order to satisfy the needs of different consumers

10.4.1 Functions of Retailers

A retailer is an important link between wholesalers and consumers In the absence of retailers it would be almost impossible to make available goods produced by manufacturers, to people living in different parts of a country On the one hand, he provides an outlet for the suppliers and on the other he facilitates the sale of goods to a large number customers While performing this dual role, a retailer undertakes various functions, which are described below:

(i) Assembling goods· A retailer procures different varieties of goods and holds adequate stock of the same. Thus, he is able to satisfy different types of requirements of the consumers.

(ii) Storing A retailer stores adequate quantities of various goods so as to maintain continuous supply to the consumers.

(iii) Personal selling· Promotion of sales is most effective through retailers because he is in direct contact with the consumers. He can advise and guide the customers in the selection of goods and easily persuade them to buy the products.

(iv) Risk bearing. Even though the retailer supplies goods in small quantities he has to bear all the risks of business such as the risks of loss or damage, changing demand and prices, etc

(v) Grading and packaging· Sometimes, retailers have to sort out goods according to the quality and other requirements. They also make

suitable package for convenience of sale to the consumers. For example, pulses and spices are graded and put in small packets for sale by most grocers.

(vi) Sales promotion. Another very important function of a retailer is sales promotion. Through effective display, shelf spacing, and various personal services like free home delivery, replacement etc. which they provide to their customers.

(vii) Market information · As retailers are in direct personal touch with the consumers, they are often helpful in providing useful market information to the wholesalers and manufacturers regarding changes in consumers tastes and preferences as well as the availability of competing goods.

(viii) Financing: The retailers generally extend credit facilities to their regular customers. This increases the volume of their business.

10.4.2 Service of Retailers

We have discussed above the various functions performed by retailers. These functions are beneficial to the consumers, wholesalers as well as the manufacturers in different ways. Let us now examine the services of retailers to the respective groups.

Service to consumers

(i) Regular availability of goods. Retailers maintain adequate stocks of a variety of goods, needed by the consumers This enables the consumers to buy goods which may be required by them from time to time. Customers are thereby assured of regular supply of goods, which they may buy in small quantities.

(ii) Wide selections: Different varieties of goods are offered for sale by retailers. This makes it possible for the consumers to select goods of their choice after comparing the suitability of alternative items.

(iii) Credit facilities: Retailers often supply goods on credit to their regular customers. This is of great advantage to the consumers who belong to the salaried class. Sometimes to promote the sales of durable goods like TV and refrigerators, retailers also offer credit facilities to customers.

(iv) Freedom to buy in small quantities. The retailers provide their customers the facility of buying goods in small quantities according to their requirements and ability to pay.

(v) New product information · By arranging effective display, and through his personal contact a retailer is able to bring to the notice of customers the arrival of new products in the market and their special features

(vi) Personal services. Retailers sometimes provide certain personal services like free home delivery to attract customers. They may also provide after sales services like supply of spare parts, repairs etc. in the case of certain products such as domestic electrical equipments.

(vii) Convenient location · Retailers generally run their business nearest to the residential areas. Hence, consumers find it easy to make their purchases from retailers without travelling long distances.

Services to wholesalers and producers

(i) Distribution of goods · The most important service of retailers is to enable the wholesalers and producers to reach the final consumers who may be widely located and thereby making goods easily available to the maximum number of people.

(ii) Market information · Retailers are able to provide useful information to the wholesalers and producers regarding market conditions like changes in customer preferences, demand etc. This becomes possible as the retailers are in regular contact with the consumers.

(iii) Sales promotion: From time to time manufacturers and distributors adopt various short-term methods of sales promotion such as contests, coupons, free gifts etc. Without the active involvement of the retailers, it would not be

possible for them to implement such schemes.

(iv) Personal selling: Some sort of personal selling effort or salesmanship is always needed to persuade customers in making purchases Retailers being the final link in the chain of distribution of goods perform this function in course of their activities. This is of great help to the manufacturers as well as the wholesalers.

(v) Enables large scale operation. Manufacturers and wholesalers are able to carry on their activities on a large scale This is possible due to the services of retailers who undertake sale of goods in small quantities to the consumers.

10.5 TYPES OF RETAIL ORGANISATION

Broadly speaking retail organisations may be classified into two main categories· (i) Itinerant traders; and (ii) Fixed shop retailers

Itinerant retailers generally include vendors like hawkers, street traders, etc These retailers, keep on moving from place to place to serve their customers They deal in low-priced consumer goods of regular use such as household utensils, toys, bangles, and miscellaneous articles of small value Fixed shop retailers on the other hand do not move from place to place in search of customers They maintain permanent shops or stores to sell their goods A retail store may deal in a variety of goods of daily necessity such as food stuffs, stationery etc. or a particular line of goods like textiles, ready-made garments, radio, television, etc.

Let us discuss the characteristics of various types of itinerant traders and fixed shop retailers

Organization of Internal Trade

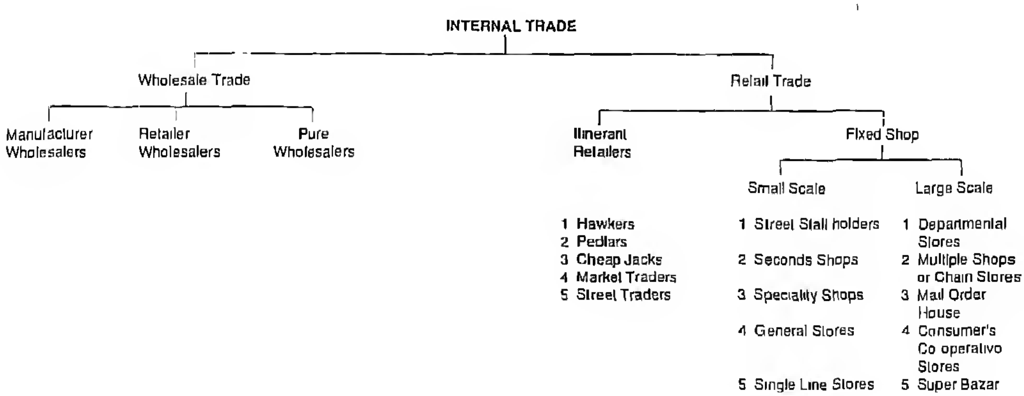

Fig. 10.1

10.5.1 Itinerant Retailers

Itinerant traders are found in all cities, towns as well as villages. The most common types of such traders are the following:

(i) Hawkers and pedlars: Hawkers and pedlars usually carry goods themselves either in a basket or in shoulder bags, or on a flat tray hanging from strings. Many of them use push carts on wheels, or bicycles or beasts of burden. They move about in residential areas and call out the names of articles they are selling. Hawkers also sell their wares in local trains and buses, in front of railway stations, at bus terminals and on busy roads.

Hawkers and pedlars generally deal in ordinary, non-standard articles. These may be vegetables, fruits, ice-cream, lozenges, utensils, toys, bangles, pen, paper, knives, etc. Convenience of buying is the main advantage derived by customers from this type of retail traders Housewives particularly find it very convenient to buy things at their doorsteps. But hawkers normally do not carry different varieties of the same product Thus, customers have limited choice.

(ii) Market traders: Retailers who sell their articles at different places on fixed market dates are called market traders. Weekly markets or 'hats' are held customarily in many villages and towns. Market traders also include those retailers who set up stalls at 'melas' or fairs and exhibitions which are organised from time to time or on special occasions like Diwali, Christmas,etc. In weekly markets, these traders sell all kinds of goods, like foodgrains, vegetables, utensils, toys, cloth, garments, etc. In 'melas' and fairs some traders also sell ladies bags, shoes, stationery, toilet articles, etc. Their customers include people from nearby places

(iii) Street traders This type of retailers generally spread their articles on pavements at busy street corners, or near railway stations or bus terminals. Many people find it convenient to buy consumer goods of daily use on their way to work or while returning home. They stop for a while to make purchases from the pavement traders. These retailers generally deal in low-priced products of common use including stationery, ready-made garments, magazines and newspapers, biscuits, confectionary, and the like.

(iv) Cheap jacks: This type of retailers set up their place of business temporarily in a business locality, and keep on shifting the location from one locality to another, depending upon the potentiality of sale. But change of place is not as frequent as in the case of hawkers, pedlars or market traders. Like street traders, cheap jacks also deal in consumer items and help consumers by making goods available where needed.

10.5.2 Fixed Shop Retailers

Retail traders who run their business in fixed shops are known as fixed shop retailers. Depending upon the scale of their operations, fixed shop retailers may be of two types: (i) small scale retailers, and (ii) large scale. The various types of retailers in these two broad categories are described below.

(i) Small scale retailers: Fixed shop retail traders who run their business on a small scale generally locate their shops in markets or residential areas. These retail shops are of five types:

(a) General stores;
(b) Single line stores;
(c) Speciality shops;
(d) Street Shops; and
(e) Seconds shops

(a) General stores: These are retail stores which deal in different kinds of consumer goods of daily use. The range of articles may include grocery items, stationery, packaged tea, edible oil, soap, toothpaste, hair oil, pen, pencils, confectionary, soft drinks, bread, butter etc. Some of these stores sell a variety of stationery and hosiery goods, toiletries, handkerchiefs, towels,

undergarments, and so on. Various kinds of standard goods of popular brand are available in a general store. Thus, customers can purchase most of their requirements at one place and thereby save time and effort of going to different shops. Sometimes the stores also offer special facilities to regular customers, like free home delivery, monthly credit, etc. However, only a limited variety of particular goods are available in these stores.

(b) Single-line stores: This type of retail shops generally deal in particular line of products, such as ready-made garments, books, medicines, watches, shoes, leather goods, etc. Hence, these shops are known as single line stores. They often stock goods of different qualities, size, design, etc. in the same product line to suit the requirements of customers. The shops are usually located in markets or near busy street crossings of cities and towns.

(c) Speciality shops: Retail shops which specialise in a single type of product instead of dealing in a line of products are known as speciality shops. Shops dealing in children's books, or ladies' garments, instead of all types of books, or garments for all, are typical examples of speciality shops. These shops are located mostly in central places.

(d) Street shops: These are very small retail shops which are also known as 'street stalls'. The stalls are set up by fixing shelves on a wall, or placing a table, or making a platform or stand to display the goods. Low-priced articles are generally sold in these stalls such as, hosiery, ball-point pens, cosmetics, magazines and story books, and the like. They are found located at street crossings or on main roads.

(e) Seconds shops: These shops sell second hand goods of different kinds, like furniture, books, clothes, and other household articles such as wall clock, table lamps etc. People who cannot afford to buy things new generally look for second hand goods. Rare objects of historical value or rare old books, also sell in the seconds shops. Customers looking for such items often pay very high prices to procure them.

(ii) Large scale retailers In large scale retailing, sale of goods, like that of any other retailer, is in small quantities. It is the volume and variety of goods dealt with that is large. Thus, large scale retailing may be defined as retail trade involving operations on a large scale and sale of goods in small quantities. There are different forms in which large scale retailing may be organised. The most common forms are:

(a) Departmental store;
(b) Multiple shops or chain store;
(c) Mail order house;
(d) Co-operative store; and
(e) Super bazar.

(a) Departmental Store. A departmental store is a retail organisation which offers a variety of products in separate departments under one roof. It is a large establishment having number of departments, each confined to a particular line of goods, like toiletries, medicines, furniture, books and stationery, electronic goods, clothing and dress material and so on. Each of the departments is like a separate shop. Centrally purchasing, selling, accounting and administrative matters of the department are managed by the departmental managers. However, all the departments are co-ordinated and controlled by the General Manager as head of the central organisation.

The main features of departmental stores are as follows:

— A wide range of products from low-priced items to very expensive goods are dealt with in separate departments under one roof.
— The store is departmentally organised. Goods offered for sale are classified and each department specialises in a particular line of goods.

- Purchases are made centrally. Sometimes, the departmental managers are entrusted with this task
- Taken as a whole, the store represents a complete shopping centre which caters to the needs of all categories of consumers, men and women, young and old.
- They are located in central places so that people may conveniently reach there from different parts of the city.
- Departmental stores provide a number of services and facilities to the customers like rest rooms, telephone booths, restaurant, etc.

Advantages

Some of the major advantages of retailing through Departmental stores are as follows:

(i) Central location. As these stores are located at central places, they attract large number of customers during the day.

(ii) Shopping facility: These stores offer a large variety of goods under one roof The shopping facility enables customers to save the time and effort of making purchases at different places.

(iii) Benefits of large scale · As the departmental stores are organised on a large scale all the benefits of large scale operation, particularly in respect of purchase of goods, are available to them

(iv) Expert services: Because of their relatively sound financial position, the departmental stores are in a better position to avail of the services of experts, in buying quality products at reasonable prices, in promoting sales, and the like.

(v) Financial resources: Having large financial resources, departmental stores are able to spend considerable amounts on advertising and sales promotion which go a long way to increase their sales

(vi) Services to customers: Departmental Stores provid various services to the customers which may include home delivery of goods, telephone facilities, credit and provision of rest room, restaurant, hair dressing saloon.

Limitations of departmental stores

Although retail selling through departmental stores has several advantages, it has also certain limitations:

(i) Lack of personal attention · Because of the large scale of operation, it is very difficult to provide adequate personal attention to the customers in a departmental store.

(ii) High operating Cost: The expenses of departmental stores on advertising, window display, interior decoration and provision of facilities, etc. make their operating cost, relatively higher than small scale retail shops. Hence the sale price of the goods is somewhat higher.

(iii) A departmental store requires huge capital to be invested. The cost of establishing it and the running costs of operation are too high.

(iv) Many people do not like to travel a long distance to reach centrally located departmental stores, particularly for buying articles of daily use

Inspite of some of these limitations the departmental stores have been very popular in some of the western countries of the world. However, this type of retail organisations have not grown in our country, except in big cities like Bombay

(b) Multiple shops or chain stores · Multiple Shops refer to retail shops owned and controlled by a single organisation and located in different parts of a city or throughout the country. These shops are also known as chain stores. Multiple

shops deal in a limited variety of products. The same line of products are available in every shop which is run by a manager. The goods are centrally purchased or produced. Prices are also fixed by the Central Office. Goods are supplied to each store from time to time according to the requirements. There is uniformity in the outward setting and interior display of products of all the stores. Chain stores may be set up by manufacturing or trading companies. In India, manufacturing companies like Mafatlal, DCM, National Textile Corporation and Bata have established their own chain stores.

Advantages

(i) Economies of scale: Because of large scale organisation of retailing with manufacturing or procurement there is considerable economy in the cost of operation of multiple shops.

(ii) Standardised products These shops deal only in standardised products; hence the buyers are reasonably assured about the quality of the products.

(iii) Spreading of risk: Since such shops are situated in different localities of a city the business risk is minimised For example, a particular item is not in demand at one store, it may be sent to another store or, if a store is not doing well, it may be shifted or closed altogether

(iv) Attractive location: Usually most of the chain stores are situated at residential locations, or in busy shopping centres. This enables the stores to serve large numbers of customers during best part of the day.

(v) No bad debts: As a matter of policy goods are sold on cash only; hence, there is no risk of any bad debt in such shops.

(vi) Easy identification: As multiple shops have uniform external appearance and internal display, they are easily identifiable by the customers and others.

(vii) Centralised advertising: Most of the advertising for all the branches is done by the central office which brings economies of scale in this regard also.

Disadvantages

(i) Individual tastes not satisfied As these shops deal in standard products it is not possible to satisfy different types of customers in situations where individual tastes and design of the products play an important role.

(ii) Limited range of goods Multiple shops deal in a limited range of goods, and customers do not have wide choice.

(iii) Inflexibility of operation Each shop is centrally controlled, there are uniform policies adopted for all with respect to price, etc This prevents the shop managers from adjusting to local conditions and opportunities

(iv) Absence of initiative The branch manager of a multiple shop is just like a head salesman. He has no initiative, no voice in making purchases and fixing prices of the goods Thus there is lack of initiative on his part.

(v) Divided attention: Manufacturers undertaking retail distribution through multiple shops, have their attention divided between production and distributions. They may not be in a position to attend to both these functions with equal efficiency.

Departmental Store Vs Multiple Shops

Both Departmental Stores and Multiple shops are forms of large scale retail organisation. But there are certain differences between the two, which are explained below:

		Departmental Stores	Multiple Shops
1	Objects	It provides goods to satisfy all requirements of the customers at one place.	They deal in a limited range of merchandise, mostly standard consumer products.
2.	Volume of Investment	It requires huge investment as large stocks of varieties of products are maintained and a number of services are provided to the customers	May require relatively small capital investment in stocks as goods needed at one place may be replenished from some other nearby place. Also they do not provide other services to the customers
3.	Credit/Cash Basis	Usually departmental stores offer credit facilities to their regular customers	Multiple shops sell goods only on cash basis and do not grant credit to customers
4	Location	Departmental stores are located at central places so as to be accessible to people from different parts of the city	These are located near residential areas or in busy markets
5.	Prices	As the emphasis is more on providing quality goods and services, the prices charged by departmental stores are relatively higher	The prices charged at multiple shops are relatively low as there is mass selling of standard products in such shops.
6.	Centralisation of Activities	There is centralised selling but purchases may be made either centrally or by the departmental managers	Multiple shops are based on the principle of decentralised selling and centralised buying of products
7	Risk	There is greater risk in departmental stores as success depends on the continued prosperity of particular geographical sites.	There is dispersal of business risk as those shops which are not very successful may be closed or shifted to some other locality.
8.	Type of Customers	It attracts customers belonging to higher income families.	They attract customers from all categories of income groups.

(c) Mail order retailing: As distinguished from other forms of retailing, in Mail Order Retailing, business transactions are made through postal communication without any personal contact with the buyers. This type of arrangement sometimes is called 'shopping by post' and from the view point of sellers, it may be described as 'selling by post'. Under this type of trading, goods are supplied to the customers without the help of middlemen and without the customers having to undertake a journey to the retailer. The sellers approach the potential buyers through advertisement and mail publicity, i.e. by sending circulars, catalogues, price lists, samples, booklets etc. The

customers are required to place their orders by post. A detailed mailing list containing names and addresses of the potential customers is maintained by mail order house. It is revised and supplemented from time to time.

Since it is not possible for the buyers to make a personal inspection of the goods only standard consumer articles with trade marks and brand names are most suitable for this system of retailing. Besides, goods which are perishable in nature, or which may be easily damaged in transit, or which is very heavy and bulky are not usually traded through mail.

Further mail order trading cannot be successful unless people are educated.

There are three types of mail order houses, which are:

(i) The manufacturing type Where the manufacturers themselves sell directly to the customers, through mail. This way they can avoid middlemen and economise on the cost of sales.

(ii) The departmental type: Some of the departmental stores, in addition to selling through different departments, undertake to supply goods by mail directly to customers.

(iii) The middlemen type This is the most common type of mail order business, where retailer receives orders by post and execute them after buying from manufacturers or wholesalers.

Advantages

(i) Mail order business can be started with limited capital as there is very little need for investment in shops, displays and large stocks.

(ii) As middlemen can be avoided under the manufacturing type of mail order business, the cost of marketing is minimised.

(iii) As the goods are sold on cash, there is no risk of bad debts.

(iv) Goods can be supplied through mail even to far off places throughout the country. This opportunity widens the scope of the business greatly.

(v) This form of business can be very convenient for the consumers as goods are delivered at their place by post, and they are not to waste time and effort in going to shops.

(vi) This type of business can be handled from any place where the postal services are available.

(vii) As the overhead expenses are minimum in this type of business, it is possible to fix prices at a reasonable level so as to attract large numbers of customers.

Limitations

(i) The buyers do not have the opportunity of personally inspecting the goods before buying.

(ii) Because of lack of personal contact many customers do not have confidence in this type of trading.

(iii) Bulky items, or perishable items, or items requiring demonstration cannot be sold through mail order business.

(iv) It is not possible for the customers to have immediate delivery of the goods. They have to bear with the delay in delivery through mail.

(v) There is great dependence on the postal department in this type of business and chances of undue delay or pilferage of goods in transit is always possible.

(vi) In cases of items where prices are subject to frequent change, there is a quick need for updating the catalogues etc. which adds to the cost of sales

(vii) There is limited scope for this type of business in places which are not well connected through postal services or where people are illiterate.

(d) Consumer's co-operative stores: Of late, the co-operative form of retailing has become very

popular in certain parts of our country Under this system the consumers themselves come together to form a co-operative society in order to protect their common interests The society enrols member either from the general public or particular groups like the employees of an organisation. The objective is to save the members from exploitation by middlemen as regards price, quality, weight etc. Retail stores run by co-operative societies formed by consumers are known as consumers co-operative stores. Such stores are owned and operated by consumers, so as to make available goods at a reasonable price. They may deal in all types of consumer goods of daily use including grocery, stationery, utensils, dress materials, medicines, etc. The articles are procured from wholesalers or manufacturers. The capital is raised by issue of shares to the members. The management of the store is entrusted to an elected managing committee Each member has a single vote, irrespective of the numbers of shares held.

In order to start a consumer co-operative store at least 10 people have to come together and form a voluntary association and get it registered under the Co-operative Societies Act. The store may sell goods to members as well as non-members but a purchase bonus is usually distributed to members whenever they make purchases for themselves. Goods are sold only on cash basis The profit earned is distributed among members as dividend.

Advantages

(i) It provides consumer goods at reasonable prices by eliminating middlemen in the distribution of the products.

(ii) The marketing costs are very reasonable as there is no need to have any large establishment, or to spend on advertisement and other sales promotion activities

(iii) There is no possibility of bad debt as goods are sold only on cash basis.

(iv) Through co-operative stores, it is possible to have some check on monopoly and wasteful competition.

(v) Because of the democratic pattern of their management the co-operatives prove to be good educators of co-operative management.

Limitations

(i) There is lack of business training or expertise in the people entrusted with management of the stores

(ii) There is great dependence on the honorary services of some members for the management of stores.

(iii) Lack of adequate financial resources of the store usually affects its functioning.

(iv) Lack of proper warehousing facilities might also adversely affect their usefulness.

(e) Super Bazar: Super Bazars are large retail stores selling a wide variety of consumer goods under one roof. These are generally organised by co-operative societies. The goods traded may include consumer goods, grocery, cloth, utensils, electrical appliances, small tools, medicines, etc. The stores are operated either on the basis of self-service or by salesmen in different countries. A super market is also a large scale retailing organisation but it is generally established as a private sector enterprise not by a co-operative society The consumers co-operative stores are run on a small scale whereas super bazars are large size organizations. Some of the important features of super bazars are:

(i) They deal in a wide variety of products, food items, groceries, as well as durable consumer goods;
(ii) These are often run on self-service basis. The customers themselves select the goods they require and make payment at the cash counter;
(iii) There are low cost retail institutions as

compared to other types of retail stores;
(iv) Goods are sold on cash basis only.
(v) These are generally opened at central locations where large numbers of buyers may reach;
(vi) These are organised by co-operative societies.

Advantages

(i) They provide great convenience to buyers as a wide range of products are offered for sale which enable them to buy most of their requirements at one place.

(ii) The prices charged in super bazar are relatively lower because of economies of large scale operation and elimination of middlemen

(iii) They offer a reasonable choice to the consumers resulting in large turnover of goods.

(iv) As all sales are made on cash basis, there is no risk of bad debt.

Limitations

(i) There is no facility of credit sale to customers.

(ii) Generally there are high administrative costs in a super bazar.

(iii) Lack of initiative on the part of employees

SUMMARY

Trade refers to the sale transfer or exchange of goods and services for a certain price exchange of goods and services is the basis of trade

Trade can be classified into two broad categories namely *internal trade* and *external trade*

1. Internal Trade

When buying and selling of goods and services takes place within a country, it is referred to as *internal trade* or *home trade*. The important features of such trade are that all payments are made in the national currency and there are no restrictions on the movement of goods

2. Wholesale Trade

Internal trade can be sub-divided into two categories on the basis of the scale of operations that is *wholesale trade* and *retail trade*

Wholesale trade consists of buying goods in bulk directly from the producers or manufacturers and selling these to retailers in relatively small quantities. Wholesalers provide a vital link between producers and retailers They act as middlemen or intermediaries in the distribution of goods and services

3. Types of Wholesalers

Depending upon their activities, the wholesalers are classified into three types, namely, manufacturer, wholesalers, retailers, wholesalers and pure wholesalers

4. Functions of Wholesalers

As an intermediary a wholesaler performs a number of functions. These are (i) Assembling of goods; (ii) Physical distribution, (iii) Breaking the bulk; (iv) Storage, (v) Grading and Packaging; (vi) Financing; (vii) Risk of distribution, and (viii) Stimulation of demand. Wholesalers also render various services to the manufacturers and retailers.

5. Services of Wholesaler

(i) Economies of scale; (ii) Providing marketing information, (iii) Help in distribution of goods, (iv) Warehousing facilities, (v) Financial support; (vi) concentration on production, and (vii) Regular supply of products

6. Services to Retailers

(i) Source of ready supply of goods; (ii) Warehousing facilities, (iii) Financing, (iv) Assumption of risk; and (v) Advice to retailers regarding market position.

7. Retail Trade

Retail trade is concerned with the distribution of goods to the ultimate consumers or users It involves buying from wholesalers or manufacturers and selling directly to the ultimate consumers

8. Functions of Retailer

A retailer is an important link between wholesalers and consumers. He provides an outlet for the suppliers and facilitates the sale of goods to a large number of customers While performing this dual role, a retailer undertakes various functions which are. (i) Assembling goods; (ii) Storing; (iii) Personal selling; (iv) Risk bearing, (v) Grading and packaging, (vi) Sales promotion, (vii) Market information, and (viii) Financing.

9. Services of Retailer

These functions are beneficial to the consumers, wholesalers and manufacturers in different ways.

Services of retailers to consumers (i) Regular supply of goods; (ii) Wide selection, (iii) Credit facilities; (iv) Freedom to buy in small quantities, (v) New product information; (vi) Personal services; and (vii) Convenient location

Services to wholesalers and producers (i) Distribution of goods, (ii) Market information, (iii) Sales promotion; (iv) Personal selling; and (v) Large scale operation.

10. Types of Retailer

Retail organisations may be classified into two main categories (i) Itinerant traders; and (ii) Fixed shop retailers.

(i) Itinerant retailers are those who keep on moving from place to place to serve their customers. They deal in low priced consumers goods of regular use. The most common types of such traders are hawkers and pedlars, market traders, street traders and cheap jacks

Hawkers and pedlars usually carry goods themselves either in a basket or in shoulder bags They move about in residential areas, and also sell their waves in local trains and buses in front of railway stations and bus terminals. They generally deal in ordinary articles

Market traders sell their articles at different places on fixed market dates They also include those retailers who set up stalls at 'melas' or fairs and exhibitions which are organised from time to time

Street traders generally spread their articles on pavements at busy street corners or near railway stations or bus terminals They generally deal in low priced products of common use including stationery, readymade garments, magazines and newspapers etc

Cheap Jacks set up their place of business temporarily in a business locality and keep on shifting

the location from one locality to another, depending upon the potentiality of sale

(ii) Fixed shop retailers run their business in fixed shops. They are of two types (a) small scale retailers and (b) large scale retailers.

(a) Small scale retailers generally locate their shops in markets or residential areas These retail shops are of the following types (i) General stores, (ii) Single line stores, (iii) Speciality shops, (iv) Street shops, and (v) Seconds shops

General stores deal in different kinds of consumer goods of daily use. The range of articles may includes grocery items, stationery, hosiery goods, drinks etc Customers can purchase most of their requirements at one place.

Single line stores generally deal in a particular line of products such as readymade garments, books, machinery shoes, etc They often stock goods of different qualities, size, design etc in the same product line

Speciality shops specialize in a single type of product instead of dealing in a line of products For example, shops dealing in children's books or ladies garments.

Street shops are set up by fixing shelves on a wall or placing a table, or making a platform or stand to display the goods. Low priced articles are generally sold in these stalls such as hosiery, pens etc

Seconds shops sell second hand goods of different kinds like furniture, books cloths, and other household articles.

(b) Large scale retailing may be defined as retail trade involving operations on a large scale and sale of goods in small quantities. It may be organised in different forms which are, departmental stores, multiple shops or chain stores, mail order house, consumers co-operative stores and super bazar.

A *departmental store* is a retail organisation which offers a variety of products in separate departments under one roof. Each department is dealing in a particular line of goods like, toiletries, medicines, furnitures, books, electronic goods and so on All departments are co-ordinated and controlled by the general manager as head of the central organisation Purchases are made centrally They also provide a number of services and facilities to the customers.

Some of the *advantages of departmental stores* and are central location, shopping facility Benefits of large scale operations, expert services and large financial resources

Some of the *limitations of a departmental stores* are lack of personal attention, high operating cost and huge capital outlay.

Multiple shops or *chain stores* refer to retail shops owned and controlled by a single organisation and located in different parts of a city or throughout the country They deal in a limited variety of products. The goods are centrally purchased or produced and prices are fixed by the central office Example of chain stores are Mafatlal, DCM, NTC and Bata

Some of the *advantages of chain stores* are economies of scale, standardized products, spreading of risk, attractive location, easy identification and centralised advertising

Some of the *limitations of chain stores* are individual tastes are not satisfied, limited range of goods, inflexibility of operations, absence of initiative and divided attention.

In *mail order retailing* business transactions are made through postal communication without any personal contact with the buyers. The sellers approach the potential buyers through advertisement and mail publicity. The customers are required to place their orders by post only Standard consumers articles with trade marks and brand names are suitable for this system of retailing.

There are three types of mail order houses namely the manufacturing type, the departmental type and the middlemen type.

The advantages of mail order retailing are limited capital, minimum marketing costs, no bad debts, convenient for consumers at reasonable prices.

Some of the limitations of mail order business are absence of personal inspection of the product, not suitable for punishable or bulking items and delays in delivery

Consumers co-operative stores are retail stores run by co-operative societies formed by consumers Such stores are owned and operated by consumers, so as to make available goods at a reasonable price. The articles are procured from wholesalers or manufacturers. The capital is raised by issue of shares to the members. The store may sell goods to members and non-members. The advantages of consumers co-operatives are reasonable prices, low marketing cost and check on monopolies and wasteful competition

The limitations of such stores are lack of business expertise, adequate financial resources and proper warehousing facilities

Super bazar are large retail stores selling a wide variety of consumer goods under one roof. These are generally organised by co-operative societies or private sector enterprises. They are run on a large scale Some of the important features are low cost, self service, central locations etc.

Some of the *advantages of super bazar* are — convenience, low prices, reasonable choice, etc. The *limitations are no* credit facilities, high administrative cost and lack of initiative.

QUESTIONS

I. OBJECTIVE TYPE

State whether the following statements are right or wrong:

1. Wholesale trade consists of buying goods directly from manufacturers in small quantities.
2. The wholesalers collect small orders from retailers and purchase in bulk from the manufacturers.
3. A retailer is an important link between wholesalers and manufacturers
4. Retailers sell different varieties of goods.
5. Prices are not uniform in all multiple shops.
6. General stores deal in a particular line of products.
7. Multiple shops mean a number of shops under one roof.
8. All departments in a departmental store sell goods at the same price.
9. Mail order houses generally deal in bulky and non-standardized goods.
10. Consumer's co-operative stores sell goods at very high prices.

II. SHORT ANSWER TYPE

1. What is internal trade? State its important features
2. What is meant by wholesale trade?
3. Briefly state the functions peformed by a wholesaler.
4. List the different types of wholesalers.
5. Define retail trade. List the various types of retail organisations.
6. Briefly explain the various types of itinerant traders.
7. What is meant by speciality shops? How do they differ from single line stores?

III. ESSAY TYPE

1. Discuss the services rendered by wholesalers to manufacturers and retailers
2. Describe the services rendered by the retailers to the consumers.
3. Distinguish between departmental stores and chain stores.
4. Discuss the various types of small scale retailers who run their fixed shops.
5. How is business transacted in mail order house? What are its advantages?
6. Consumer's co-operative stores are formed to protect the consumers common interests. Discuss.
7. Explain the features, advantages and limitations of super bazar

CHAPTER 11

External Trade

LEARNING OBJECTIVES

After reading this chapter, you should be able to.

1. explain the nature and importance of external trade,
2. describe the basis of external trade;
3. interpret price quotations;
4. explain the terms of shipment and methods of payment in export-import operations;
5. describe the procedure involved in export trade, and the documents used;
6. state the nature of export finance provided by banks;
7. give an outline of the import procedure and documents used in that connection.

11.1 INTRODUCTION

External trade or foreign trade involves trading of goods among countries of the world. Every country, big or small, buys and sells different goods from and to other countries. Goods worth crores of rupees are bought and sold every year Foreign trade is an important economic activity because it enables the countries participating in it to secure resources for economic development as well as for satisfying the needs of consumers. For some countries, foreign trade is the most essential economic activity because most of their industrial activities depend on it. For example, economic development of Hong Kong, Singapore, South Korea, and Japan has been largely due to their foreign trade. Before it lost its colonies, the United Kingdom was the largest world trader By 1987, West Germany had become the largest exporter, followed by USA, Japan, France, UK, Italy, USSR, Canada and Netherlands On the other hand, USA was the most important importer followed by West Germany, France, UK, Japan, Italy, USSR, Netherlands, and Canada. The world trade is dominated by the rich developed countries and the developing countries of Asia, Africa and Latin America have a small share.

Like other countries, India imports and exports a large number of goods. After independence, foreign trade of India has considerably expanded. For economic development, it was necessary to import machinery, raw materials and fuel oil. As a result, imports into India increased. However, it was considered necessary to increase exports to pay for imports. Suitable export promotion measures were adopted by the government and exports from India increased. Imports into India have been more than exports, and this gap between imports and exports called 'Balance of Trade', has widened (See Table 11.1). When imports are greater than exports, the balance of trade is said to be negative or adverse. In case of India, balance of trade has been adverse in the post-independence period.

11.2 NATURE OF EXTERNAL TRADE

External trade or foreign trade refers to buying and selling of goods and services between the nationals of different countries living across political frontiers, or trade between agencies of the governments of different countries

It consists of *export trade* and *import trade* Exports involve sale of goods and services to other countries Imports consist of purchases from other countries. When goods are traded by way of imports and exports the transactions are regarded as *visible trade*. External trade in services is referred to as *invisible trade* Thus, for example, if Indian exporters avail of British shipping services for transportation of goods, they have to pay for the transport services. Hence services used may be called *invisible imports* by India, and sale of services would be regarded as *invisible exports* from Britain.

When goods are imported into a country with the purpose of re-exporting them to some country, it is known as *entrepot trade.*

11.3 IMPORTANCE OF EXTERNAL TRADE

The necessity of external trade arises mainly because no country is capable of producing every thing equally efficiently for the consumption of its people and the development of its economy. This is due to the unequal distribution of resources and skills among different countries of the world. External trade enables every country to specialise in the production of those goods for which it has relatively more resources, facilities and skills as compared with other countries. It may thus be in a position to export its surplus production of those goods and import other goods from countries which possess greater relative advantages of production. Thus, every country can derive the benefit of geographical specialisation from external trade. People can be provided

with a variety of consumer goods produced economically, and economic development can be ensured on the basis of imports of machinery, raw materials and technical skill.

However, specialisation does not mean that a country will import and export the same kind of products for ever. Comparative advantage may shift from one group of products to another in course of time. For example, India was earlier dependent on developed countries for its requirements of certain types of machinery and equipments. But over the years India has developed the capability of producing many of those items efficiently. Thus the pattern of external trade of India has changed

External trade is beneficial to a country in the following ways. Its importance lies in its advantages to both the trading partners.

(i) External trade leads to better use of available resources in the country, and thus improves the standard of living and well being of the people. This is possible due to imports of goods which are more efficiently produced elsewhere, and production of goods of which the country possesses necessary resources and skill for economical production;

(ii) Economically under-developed countries can develop faster with the help of imported machinery, equipments and technical skill from developed countries;

(iii) Import and export of essential commodities often reduce violent fluctuation of prices of those commodities in the country, when there is domestic shortage or surplus. Deficiency of supply or shortage of goods due to natural calamities can also be met by imports of surplus available in other countries;

(iv) External trade relations facilitate cultural contacts with the people of other countries which automatically lead to spread of knowledge and skill.

11.4 BASIS OF FOREIGN TRADE

All countries depend on one another for obtaining goods they need. This dependence takes the form of exchange of goods among them. The countries import those goods which help them in increasing their rate of economic development. Imports are also made for providing the people a variety of consumer goods like food stuffs, clothing, automobiles, radios, televisions, etc. To pay for imports, those goods are exported to other countries which are demanded by these countries. For example, India exports such goods as gems and jewellery, readymade garments, leather products, iron ore, jute manufacturers, engineering goods and tea and imports in return machinery and equipment, petroleum and petroleum products, chemicals and edible vegetable oils.

11.4.1 Theory of Comparative Cost Advantage

The basis of foreign trade lies in the fact that a country cannot produce all goods that it needs. It has to import those goods which it cannot produce.

Further, a country can produce certain goods but at a cost higher than another country while it can produce certain goods at a lower cost. These production limitations are due to the fact that every country possesses different kinds and amounts of factors of production or productive resources. These resources such as land, raw materials, minerals, water, labour, managerial skills, etc. determine the capability of a country to produce goods. Thus, in a country which has more of certain resources, their cost will be relatively less than other countries. In other words, the country has cost advantage in production of those goods which use more of these abundant resources. This country will, therefore, be able to export those goods which it can produce relatively cheaper and import those goods which will cost more to produce. For example, India has a large number of skilled workers for cutting and

polishing rough diamonds. That is why India has become a major world exporter of cut and polished diamonds though bulk of rough diamonds are imported. Similarly, India is a major exporter of tea because of fertile land in Assam and West Bengal (Darjeeling). On the other hand, Japan has the most modern technology for producing electronic products cheaply which are exported to other countries. Again, Saudi Arabia exports a large quantity of crude petroleum because nature has given it large reserves of oil. The theory that explains the basis of foreign trade is called the theory of "comparative cost advantages".

11.5 EXPORT-IMPORT OPERATIONS

11.5.1 Importance of Export Trade

Exports may be regarded as counterparts of imports. Without exports a country cannot make necessary imports. This is because payment for imports has to be made in foreign exchange, and it is only through exports that a country can earn the necessary foreign exchange. Indeed, if exports fall short of imports, the importing country runs into foreign indebtedness, that is, it leads to foreign borrowing. In other words, adverse balance of trade indicates the amount of foreign debt incurred by the importing country This often leads to an unfavourable change in the rate of exchange between the currencies of the importing and exporting countries. Accumulation of foreign debt beyond a reasonable limit needs curtailment or restriction of imports. Thus, to meet the import bill it is essential that exports should be encouraged.

11.5.2 Price Quotation and Terms of Shipment

Exports and imports are two sides of the same business operation. Thus, while an exporter is constantly making efforts to identify potential sales opportunities, an importer is always on the lookout for buying goods at low price.

In foreign trade, *Terms of Shipment* — also known as *Special Trade Terms* — are very important for concluding a contract or an agreement to buy/sell goods These terms reflect two aspects of the contract:

(i) Sale price or the price quotation;
(ii) Responsibility of exporter in meeting the shipment (transport) cost and manner of shipment.

The most commonly used terms are:

(a) Free on Board or FOB (Port of Shipment): Under this price quotation the exporter bears all costs of shipment till the goods are placed in the carrier—ship/aircraft.

(b) Cost and Freight or C & F (Port of Destination). Under this price quotation the exporter pays freight for carriage in addition to FOB cost Therefore, C & F = FOB + Freight.

(c) Cost, Insurance and Freight or CIF (Port of Destination): Under this price quotation, the exporter pays insurance premium in addition to C & F cost Therefore, CIF = C&F + Insurance Premium.

Every export contract has a date by which goods must be shipped Since this is an important term of agreement or contract, the exporter must ship the goods before or on this date of shipment. If goods are shipped after this date, the importer may not accept the goods and not pay for them.

11.5.3 Terms of Payment and Export Finance

While terms of shipment determine the responsibility of exporter to send goods to the importer, terms of payment determines the manner of payment for goods by the importer. Generally, goods are shipped first and the exporter is paid thereafter. In such a situation, the exporter will try to protect himself by arranging favourable terms of payment. This he does by arranging shipment in such a manner that the importer cannot get goods from the carrier (ship/aircraft) before he has paid for the goods. This payment is made through the bank at the destination.

There are five terms or methods of payment These are.

(i) Advance Payment;
(ii) Open Account;
(iii) Documentary Bills;
(iv) Documentary Letter of Credit;
(v) Direct Remittance.

(i) Advance payment: This method is most advantageous to the exporter He receives payments either on signing of export contract (agreement) or any time before shipment is made. The importer pays to the exporter by means of bank draft, mail/telegraphic transfer or international money order.

(ii) Open account Under this method, the exporter supplies goods to the importer, but he does not receive payment immediately. Instead the importer sends payment on periodic settlement of account This is a risky method for the exporter because there is no intermediary (i e bank) to protect interests of the exporter.

(iii) Documentary bills. Also known as 'Documentary Collection', this method requires a definite role played by the bank Under this method, a document known as 'Bill of Exchange' is prepared by the exporter after shipment which is given to the exporter's bank alongwith the transport document showing shipment of goods. The exporter's bank sends these documents to the importer's bank which asks the importer to honour Bill of Exchange first and make payment. The transport document is given to the importer subsequently.

A *Bill of Exchange* may be defined as an order given by the exporter to the importer to pay the amount of sale value mentioned on it, generally through the banking channel. Since payment by means of Bill of Exchange is linked with the transfer of the transport document, this method is known as Documentary Bills.

Bill of Exchange is of two types· (i) Sight Bill; and (ii) Usance Bill. When Sight Bill is made and presented to the importer, he has to make payment immediately before transport document is given to him. This method of payment is known as D/P or *Documents Against Payment.*

When agreement between exporter and importer provides for credit to be extended by the exporter for a certain period of time, a *Usance Bill* is prepared It is quite common in foreign trade that goods are sold on credit, generally ranging between 30 days and 180 days In such a situation, the agreed method of payment is known as D/A or Documents Against Acceptance and a Usance Bill of Exchange is prepared by the exporter. Under this method, the importer accepts the Bill of Exchange first by signing on it Acceptance means that the importer promises to make payment on the agreed date or on the expiry of an agreed period of time. The Bill of Exchange thus accepted is retained by the importer's bank who hands over the transport document to the importer The bank will present the Bill of Exchange to the importer for payment at maturity.

Under the Documentary Bills, method of payment, following activities are involved:

(a) The exporter hands over the goods to the shipping company/airline and a receipt is issued This receipt is known as *Bill of Lading* when goods are sent by sea and *Airway Bill* when goods are sent by air;
(b) The exporter prepares *Bill of Exchange* which requires the importer to pay the amount of sale value of the goods sent;
(c) The exporter also prepares other documents of sale such as *Commercial Invoice* and *Packing List*,
(d) After shipment, the Bill of Exchange attached with the Bill of Lading/Airway Bill, Commercial Invoice and Packing List are handed over to the bank in the exporting country,
(e) Bank in the exporting country sends these documents to the importer's bank at the destination,

(f) The importer's bank first presents the Bill of Exchange for payment;
(g) After payment is received, the importer's bank hands over the remaining documents (Bill of Lading/Airway Bill, Commercial Invoice and Packing List) to the importer. Payment thus received is sent to the exporter through the exporter's bank;
(h) The importer gives the Bill of Lading/Airway Bill to the shipping company/airline and receives the goods in return

In this way, the importer gets the goods he had ordered and the exporter payment of the sale value amount.

(iv) Documentary letter of credit: This is a standard means of settling payments in international trade in which an instrument (document) called Letter of Credit is issued. A letter of credit contains promise or guarantee by the importer's bank on behalf of the importer to make payment to the exporter on presentation of documents mentioned in the letter of credit. The documents against which payment is made show that the goods ordered by the importer have been shipped in accordance with the terms of export contract or agreement. In this method, banks play a direct role in ensuring payment to the exporter.

There are four parties to a letter of credit. These are.

(a) Applicant: The importer of goods.
(b) Issuing bank· Importer's bank who gives guarantee to make payment
(c) Advising and negotiating bank: Bank in the exporting country through which letter of credit is sent to the exporter and to whom documents mentioned in the letter of credit is submitted after shipment. Generally this is also the exporter's bank.
(d) Beneficiary: Exporter of goods.

The method of payment through letter of credit operates in the following manner. Graphical representation is given in figures 11.1 and 11.2.

(a) Opening and advising. After export agreement is signed, the importer (Applicant) instructs his bank (Issuing Bank) to issue a letter of credit in favour of exporter (Beneficiary) The Issuing Bank sends the letter of credit to its branch or correspondents (Advising Bank) in the exporting country for giving it to the exporter (Beneficiary). He accepts the letter of credit containing terms of shipment
(b) Shipment of goods· The exporter ships the goods and gets the transport document — Bill of Lading/Airway Bill — as proof of shipment. He also prepares and obtains other documents needed under the letter of credit.
(c) Presentation of documents: The documents as mentioned in (ii) above are presented to the exporter's bank (Advising and Negotiating Bank). After preliminary checking, the documents are sent to the importer's bank (Issuing Bank)
(d) Payment of amount: The importer's bank (Issuing Bank) examines documents with reference to requirement under the letter of credit. If documents are in order, the bank pays the sale amount to the exporter through the exporter's bank (Negotiating Bank).
(e) Release of goods: After debiting the amount (paid to the exporter) in the account of the importer, the importer's bank hands over the shipping documents including bill of lading/airway bill to the importer. The importer surrenders bill of lading/airway bill to the shipping company/airline and gets the goods in return.

(v) Direct remittance: Under this method, goods are sent directly to the importer. Exporter also sends to the importer the documents to facilitate him get the goods at the destination. After receipt of documents, the importer sends the cost of goods direct to the exporter, by draft or

telegraphic transmission through banking channels. This is a very risky method for exporter because goods and shipping documents are sent directly to the importer without ensuring payment.

11.6 EXPORT FINANCING BY BANKS

An exporter may need financial assistance from his bank at two stages — pre-shipment and post-shipment. At the pre-shipment stage, he needs finances for producing goods while after shipment he needs finances until he gets payment from the importer. Banks in India provide financial assistance at the pre-shipment stage to exporters at concessional rates under export promotion scheme of the Government of India. The pre-shipment credit is given to an exporter to enable him to purchase raw materials, process them and convert them into finished goods for the purpose of export. This is given on the basis of letters of credit as well as an export order. Finance at the post-shipment stage is given to the exporters in the form of advances against bills of exchange or against shipping documents drawn under letter of credit.

11.6.1 Assistance by Exim Bank of India

Export-Import Bank of India is a specialised financial institution for promoting foreign trade of India. It was established on January 1, 1982. Its main function is to coordinate the working of institutions engaged in financing of export and import. It provides export credit for medium-term and long-term where exporters have to offer sale on deferred credit basis. It also finances export of consultancy and related services. It assists in setting up joint ventures in other countries and promotion of export-oriented industries in India. Consequently, it provides loans to Indian companies engaged in project export, pre-shipment credit beyond six months, loans to foreign governments and companies to enable them to buy goods from India and loans to commercial banks in India to enable them to extend credit to Indian exporters. It also undertakes export market studies and provides merchant banking services.

11.7 EXPORT DOCUMENTS

11.7.1 Importance of Documents

Documentation is an important activity in the export trade. The export trade cannot take place without certain documents. These documents protect the interests of the exporter as well as the importer. Through these documents, the importer is able to get the goods he has ordered and the exporter is able to get his sale value. In good old days, the merchants used to carry goods in their own ships to other countries. They would sell them and buy in return other goods to be carried back to their own countries. The act of sale and purchase between the exporter and the importer was simultaneous. In the modern age, the goods of the exporter are carried to the importer in a ship belonging to the third party. The exporter hands over the goods to the shipping company. Thereafter the exporter has no physical control over the goods. He is not sure whether he will get the sale value. In such a case, the exporter will like to ensure that the importer is not able to get the goods from shipping company at the destination unless he has paid for the goods. Of course, the importer wants to ensure that the goods have been properly shipped.

11.7.2 Shipping Documents

For protecting interests of the importer (i.e. proper shipment of the contracted goods) and the exporter (i.e. remittance of sale value) a set of 'Shipping Documents' are sent to the importer through exporter's bank. One of the documents in the set (Bill of Lading/Airway Bill) will enable the importer to get the goods released from the shipping company/airline at the destination. The bank, however, will give these documents to the

importer only after he has paid the amount of sale value.

The main *Shipping Documents* are:

(i) Commercial Invoice;
(ii) Bill of Lading/Airway Bill;
(iii) Insurance Policy;
(iv) Bill of Exchange.

(i) Commercial invoice: It is prepared by the exporter. It has two features. It is a document of contents and it serves as a bill made by the exporter to the importer. As a document of contents, it contains the following information:

(a) Description of goods;
(b) Number of packages, and
(c) Weight and volume of packages.

As a bill, it contains the following information:

(a) Name and address of importer;
(b) Export Order No. and date;
(c) Per Unit Value of goods;
(d) Total Value; and
(e) Terms of Payment of Goods.

The commercial invoice also gives information about the terms of shipment (e.g. FOB/C&F/CIF), date of shipment, name of ship flight No., etc.

(ii) Bill of lading: When goods are sent by a ship the bill of lading is issued by the shipping company. It is a receipt given by the shipping company to the exporter for carrying the goods to the importer. It is a proof of shipment. This document assures the importer that goods which he had ordered have been shipped. When goods reach the destination, the importer gets them from the shipping company in return of Bill of Lading.

Bill of Lading contains the following information:

(a) Name of shipper (i.e. exporter);
(b) Name of consignee (i.e. importer);
(c) Name of notify party (i.e. the one whom information on arrival of the ship at the destination is to be sent by the shipping company);
(d) Identification marks on packages;
(e) Description of goods,
(f) Freight charges;
(g) Number of packages;
(h) Name of ship;
(i) Goods weight and volume;
(j) Port of shipment;
(k) Port of destination;
(l) Date of shipment;
(m) Condition of goods at the time of loading.

Airway bill: When goods are sent to importer by air, airway bill is issued by the airline to the exporter through which goods have been sent. It is a receipt given by the airline for the goods it is carrying. At the destination it will be surrendered by the importer to the airline for releasing goods It contains such information as name and address of exporter, name and address of consignee or importer, description of goods, number of packages, weight and volume of goods, rate of freight and total freight, airports of loading and destination, flight number and date, etc.

(iii) Insurance policy: The Insurance Policy is issued by the insurance company. Insurance of goods is required so that if goods are lost or damaged on the way from the exporter to the importer, this loss can be recovered from the insurance company. Goods are exposed to different kinds of risks or dangers such as fire, sea water, theft and pilferage, war and strike. If there is no insurance, then the loss will have to be borne by the owner of the goods — exporter or importer. Under CIF contracts, insurance is taken by the exporter while under FOB contracts, insurance is generally taken by the importer. For covering different risks, there are different types of insurance policies. Insurance cover is generally given from the warehouse of the exporter to the warehouse of the importer.

(iv) Bill of exchange: This document is prepared by the exporter after shipment. Since it is attached with other documents, it becomes a documentary bill. It serves the purpose of getting

sale value by the exporter. Like other shipping documents, this document is also sent through the bank to the importer. The importer will have to honour this document first and other documents will be given to him afterwards. The importer will pay the amount of money written on it. Alternatively, he will sign this document and return it to the bank in case the exporter has extended credit to the importer. The bank will present it on the date as agreed between the exporter and the importer for payment.

11.8 EXPORT PROCEDURE

11.8.1 Export Restrictions

Except for some restrictions, an Indian exporter can export any product anywhere. The restrictions cover a few products and some destinations Products where restrictions are applied are mentioned in the Export Trade Control Policy of the Government of India. For example, the national bird (peacock) cannot be exported. Similarly, exports of readymade garments to USA and West Europe are subject to quota restrictions (restrictions on quantity) Among destinations where exports cannot be made is South Africa.

There is another restriction on export A large number of products are subject to compulsory quality or pre-shipment inspection. These products can be exported only after the exporter has obtained an Inspection Certificate from an inspection agency approved by the Government of India.

For sending goods outside India, permission from the Customs Authorities is essential. This permission is granted only after the goods have been physically examined by the Customs Officials.

11.8.2 Registration with RBI and JCCI&E

A company in India can enter export-import business after it is registered with the Reserve Bank of India (RBI) and the Joint Chief Controller of Imports and Exports (JCCI&E) RBI which co-ordinates the receipt of foreign exchange by the exporting companies requires that every company before entering export business must obtain an RBI Code Number. This is a permanent number of the company which is to be mentioned in different documents for obtaining permission from the customs authorities for shipment of goods. RBI Code Number is given to a company on the basis of submission of a document called CNX Form accompanied by a report of financial standing of the company given by the company's bank

Importer Exporter Code Number (IEC) is allotted by the JCCI&E which co-ordinates the grant of export and import licences. For obtaining IEC, the company has to fill up a document also known as IEC form for submission to the office of JCCI&E On the basis of this document IEC Code Number will be allotted to the company.

11.8.3 Registration with Export Promotion Council

The Government of India gives a number of incentives to exporting companies to encourage them to increase exports One such incentive is called Cash Compensatory Support of Cash Assistance which is given after exports have been made. This assistance is given as a percentage of FOB value of the exported goods.

Another incentives is called Import Replenishment Licence (or REP Licence) which enables an exporting company to get an import licence for importing a number of raw materials, capital goods, etc. which are otherwise not allowed to be imported in India. For obtaining these incentives, an exporting company is required to be registered with the concerned Export Promotion Council/ Commodity Board There are a number of Export Promotion Councils and Commodity Boards looking after export promotion of specified products For example, Engineering Export Promotion Council looks after the promotion of exports

of engineering goods from India. For registration with the concerned export promotion body, an exporting company has to submit an application called the Registration-cum-membership Certificate Form accompanied by a certificate from the exporter's bank and membership fee. On the basis of these documents, the export promotion agency issues a Registration-cum-membership Certificate (RCMC).

11.8.4 Obtaining Export Order

After identifying the potential buyer of goods in a country, the exporter sends his offer to the buyer (importer).

This offer may be sent either in the form of a Proforma Invoice or Quotation/Offer. These documents contain the following information

(i) Name and address of importer;
(ii) Specifications of goods;
(iii) Unit price;
(iv) Quantity of goods;
(v) Total number of goods;
(vi) Currency in which offer is given,
(vii) Terms of shipment (FOB, C&F, CIF);
(viii) Terms of payment (D/P, D/A, Letter of Credit),
(ix) Last date of validity of the offer.

Usually three copies of the offer are sent by the exporter to the importer. If the importer agrees with the terms of offer, he signs one of the copies and returns it to the exporter. After signing, the offer becomes an export contract or export order. Sometimes, the importer makes out his indent on the basis of the terms of offer sent by the exporter This indent order is made on the form prepared by the importing company. On receipt of the indent order from the importer, the exporter accepts it and an export contract or order is concluded.

11.8.5 Processing of Export Order

An export order is processed in the following manner

Stage I : Production and inspection of goods: The exporter manufactures the goods or buys them from the Indian market and packs them. These goods must be the same as ordered by the importer Even packing must be according to the export order. The goods are then offered for inspection to the Export Inspection Agency. For this purpose, an application is made to the Export Inspection Agency which will send its inspector to the factory or the warehouse of the exporter. After goods have been inspected, an Export Inspection Certificate is issued. This Certificate is to be submitted to the Customs Authorities alongwith other documents for customs clearance

Stage II. Movement of goods to port town: The exporter sends the goods to the port town from where these are to be shipped. These may be sent either by rail or by road After goods are loaded into the carrier (railway wagon/truck), a receipt is issued. When goods are sent by rail, a Railway Receipt (RR) is issued In case of transport by road, a Lorry Receipt (LR) is issued. This receipt is endorsed by the exporter in favour of his Clearing and Forwarding Agent. This Agent is appointed by the exporter for performing a number of functions including reservation of space in a ship, making arrangements for sending goods to the shipment shed in the port town where goods are to be loaded, obtaining permission from customs authorities and obtaining bill of lading from the shipping company.

For getting space reserved on a ship by which goods are to be sent, the exporter or his agent approaches the shipping company. When space is reserved, the shipping company issues a document known as Shipping Order. Shipping Order shows details of goods and the port of destination and it instructs the ship's Master to accept these goods for carriage.

Stage III Processing of shipping bill: When goods reach the port town, the clearing and for-

warding agent gets them from the railway/truck on presentation of railway receipt/lorry receipt. The agent then proceeds to get permission from the customs authorities to ship the goods. This permission is granted in two stages. At the first stage, the Customs House (office) grants permission on the basis of documents submitted by the agent of the exporter. In the second stage, permission is given in the port shipment shed after physical check of the goods. For the first stage of permission, the exporter's agent fills up a document known as 'Shipping Bill', which is prescribed by the customs authorities. Shipping Bill contains such information as (i) port of loading and port of discharge; (ii) exporter's name and address; (iii) name of ship, (iv) identification marks on packages, (v) description of goods, (vi) value of goods; and (vii) country of destination. Alongwith the Shipping Bill, the exporter's agent submits a number of documents.

Stage IV : Port formality and customs examination: After obtaining permission to bring the goods for shipment on the Shipping Bill, the exporter's agent pays port charges and brings the goods in the shipment shed. At this stage, a customs officer will physically examine the goods on the basis of declaration given in the Shipping Bill. The examination is done on a sample check basis. If the customs officer is satisfied, he gives permission to load goods on the ship.

Stage V : Mate's receipt and bill of lading: When goods have been loaded on the ship, the ship's Master issues a document called 'Mate's Receipt' (MR). This receipt gives the proof that goods mentioned in it have been shipped (loaded). Mate's Receipt is a very important document because it becomes the basis for the final transport document, i.e., Bill of Lading. The exporter's agent gets MR and goes to the office of the shipping company to get Bill of Lading. He surrenders MR, pays the freight and gets Bill of Lading.

Stage VI : Submission of documents to bank: The Clearing and Forwarding Agent sends the Bill of Lading to the exporter. The exporter prepares the final Commercial Invoice and Bill of Exchange. He then submits the following documents to the bank for getting payment:

(i) Commercial Invoice;
(ii) Bill of Exchange;
(iii) Bill of Lading;
(iv) Insurance Policy (if contract is on CIF basis);
(v) Any other document required by the importer.

11.9 IMPORT DOCUMENTS AND PROCEDURES

11.9.1 Importance of Import Trade

Countries all over the world are dependent on imports from other countries to fulfil their requirements. Imports are effected because a country cannot produce everything that it needs due to limited natural and other resources. Similarly, it cannot produce all goods it requires at low cost of production. Thus, it can use its available production resources efficiently in producing those goods in which it has a relative cost advantage and import those goods which other countries can supply at relatively less cost. Import trade, therefore, an important economic activity. The capacity to import by a country is determined by the level of exports. Exports to other countries enable a country to earn foreign exchange which is used for paying for imports. Thus, a country which has a high level of exports can import more than another country which has a low level of exports. The developing countries of the world including India cannot import to the full extent of their requirements because of low level of exports. These countries suffer from shortage of foreign exchange and therefore, are compelled to restrict imports. They plan the expenditure of foreign exchange earned by them to import essen-

tial requirements for developmental purposes as well as for satisfying basic needs of their people such as foodgrains and edible oils

11.9.2 Import Controls and Policy

Like many countries in the world, imports into India are controlled. This control in India is exercised through Import Policy announced by the Government of India. Under the Policy, different lists of items are provided which are prohibited for imports and are restricted or otherwise controlled. Items which are not banned or prohibited are allowed to be imported either under an import licence or a customs clearance permit. Some of the items, however, may be imported without any licence or permit but subject to some conditions These items are known as Open General Licence (OGL) items. Again, there are certain items which can be imported only by public sector agencies like State Trading Corporation and Minerals and Metals Trading Corporation. These items are called canalised items.

India's Import Policy has two main parts — Import Policy for Actual Users and Import Policy for Registered Exporters.

Import Policy for Actual Users concerns imports to be made by a person, a company or an institution for own use and not for business and trade. For example, a manufacturing company may import steel for manufacturing hand tools but it cannot sell imported steel in the market. Similarly, a laboratory may import equipment for its own use. Under this policy, import licences are given for import of capital goods as well as raw materials and spare parts.

Policy for Registered Exporters gives a preference to the exporters to import different items for use in manufacture of export goods. This part of import policy is quite liberal to encourage exports. Exporters are allowed to import raw materials, components, spare parts, capital equipment, office equipment, etc. These items are otherwise not generally allowed to be imported. This policy is applied only to those exporting companies which are registered with the concerned Export Promotion Councils or Commodity Boards. The most important part of the Policy for Registered Exporters is the Replenishment Licence (REP), details of which have been discussed in an earlier section.

11.9.3 Import Procedure

Imports can be made by those companies which have obtained Import Export Code Number from the Joint Chief Controller of Imports and Exports (JCCI&E). Procedure for obtaining this number has been discussed in an earlier section. The procedure for making imports into India is as follows:

Stage I : Location of importer: The usual source to locate an overseas supplier is the trade directories of exporters/manufacturers/dealers brought out by various organisations in different countries. In many cases, foreign suppliers have their agents and representatives in the importing country. In India, such agents are operating from port towns like Bombay, Calcutta and Madras.

Stage II : Conclusion of contract: The importer corresponds with the potential supplier (exporter) to conclude a contract. Once the need of the importer is understood by the supplier, the importer writes to the supplier to send a Proforma Invoice giving details of the offer. On receiving Proforma Invoice (generally three copies), the importer signs one of them and returns it to the exporter. Alternatively the importer may prepare a Purchase Order giving details of goods and terms of shipment and terms of payment. At this stage, the import contract is concluded.

Stage III : Obtaining import licences: The importer applies to the licensing authorities for grant of import licence. For this purpose, he makes out an application in the prescribed form and submits it to the licensing authorities with required supporting documents. On the basis of

the application, import licence will be issued to the importer.

Stage IV : Opening letter of credit According to regulations in India, payment to foreign supplier can be made only through bank authorised to deal in foreign exchange Moreover, payment must be made from the bank account of the importer. Hence, importers have to deposit the required amount in their bank account After the amount has been deposited in the bank account, the importer instructs his bank to open letter of credit in favour of his supplier. The bank will issue a letter of credit on the basis of copy of import licence and proforma invoice given to it by the importer.

Stage V : Negotiation of documents. The foreign supplier sends the goods to the importer. He also sends shipping documents through his bank to the importer's bank. These shipping documents are: Commercial Invoice, Bill of Lading, Bill of Exchange and Insurance Policy. On the basis of these documents, the importer's bank will transfer the payment to the foreign supplier through his bank. Except for Bill of Exchange, other documents will be handed over to the importer.

Issue of Letter of Credit

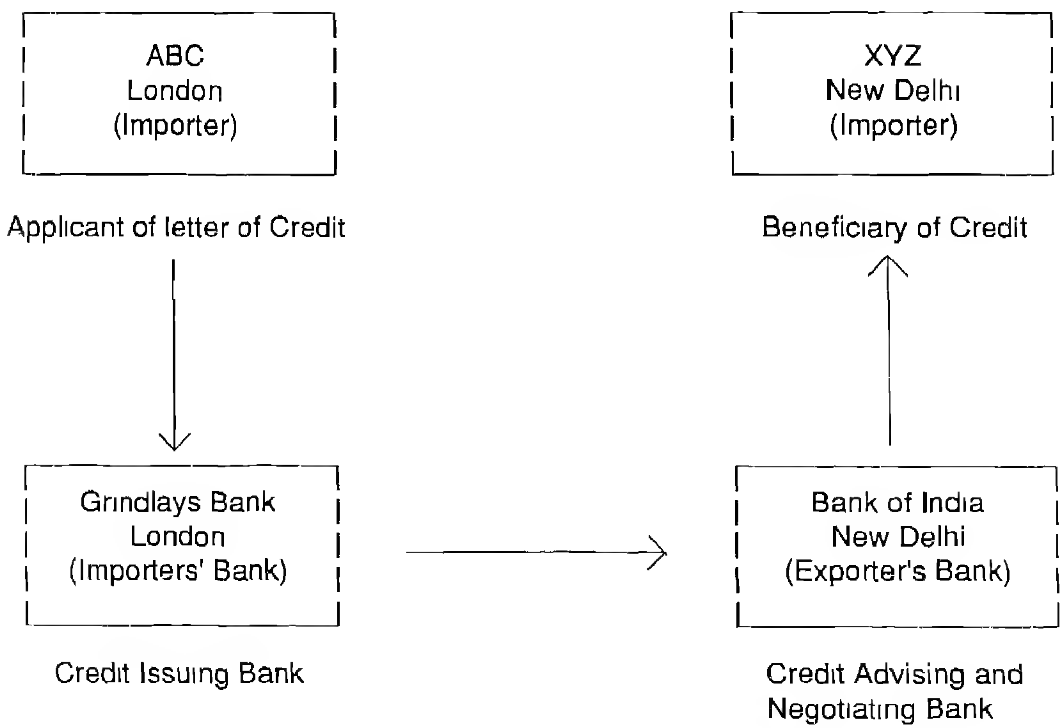

Fig.11.1

Stage VI : Customs clearance: The exporter approaches the customs authorities to pay import duty, if any, and clear the goods from customs warehouse. For this purpose the importer or his agent submits a document called Bill of Entry alongwith other documents. The customs office calculates the amount of duty to be paid and examines other documents to find that the exporter has the import licence for the goods. Exporter or his agent pays the required import duty and a release order is issued by the customs office. On the basis of the release order, goods are given to the exporter from the customs warehouse.

Utilisation of Letter of Credit

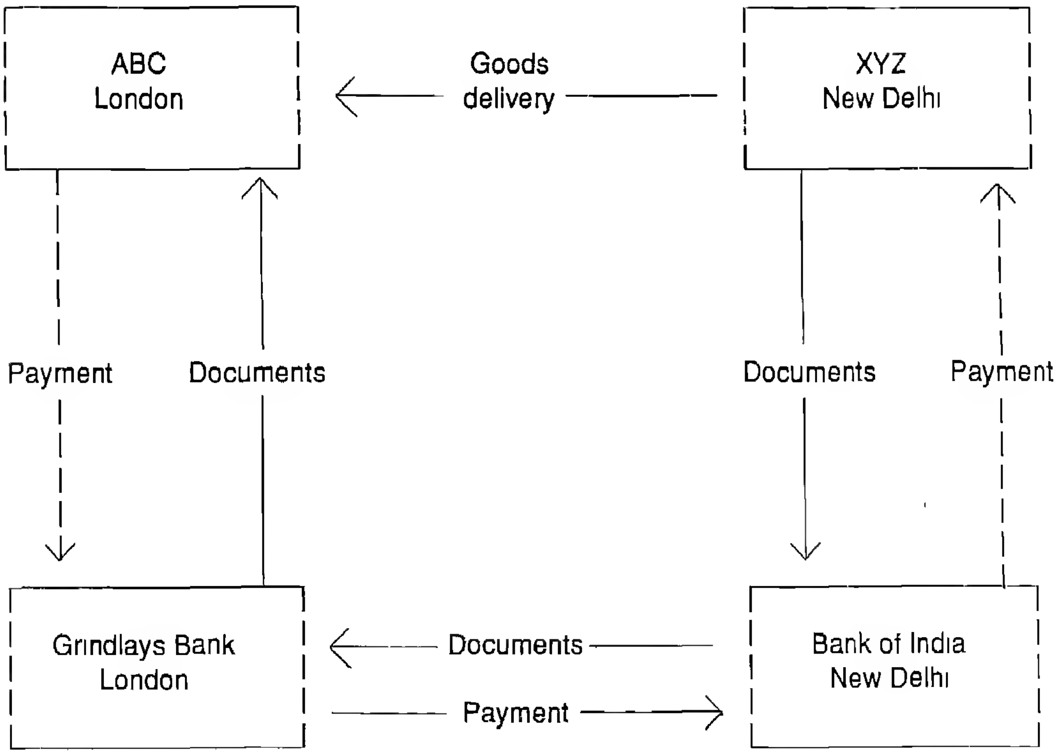

Fig 11.2

Table 11.1

(i)Trend in India's Foreign Trade

Value: Rs. Crore

Year (1)	*Import* (2)	*Export* (3)	*Balance of Trade* (3-2)
1951-52	970	732	— 238
1961-62	1107	680	— 427
1971-72	1825	1608	— 217
1981-82	13608	7806	— 5802
1982-83	14360	8834	— 5526
1983-84	15831	9771	— 6060
1984-85	17134	11744	— 5390
1985-86	19658	10895	— 8763
1986-87	20083	12566	— 7517

Source: Ministry of Commerce, Government of India.

(ii) <u>India's Major Export Markets</u> (1986-87) : USA, USSR, Japan, West Germany, UK, Hong Kong, Belgium, Italy, UAE, France, Netherlands, Singapore, Saudi Arabia.

(iii) <u>India's Major Suppliers (Importers)</u> (1986-87) Japan, USA, West Germany, UK, Belgium, USSR, Saudi Arabia, France, Malaysia, Italy, Australia, Netherlands.

(iv) <u>India's Principal Exports</u> (1986-87) : Jems & Jewellery, Readymade Garments, Leather Products, Engineering Goods, Cotton Fabrics, Yarn & Made-ups, Iron Ore, Tea, Marine Products, Plastic and Linoleum Products, Petroleum Products, Cashew Kernels, Coffee, Spices, Jute Manufactures.

(v) <u>India's Principal Imports</u> (1986-87) · Machinery other than Electric, Petroleum Products, Pearls, Precious and Semi-precious Stones, Iron & Steel, Electric Machinery, Transport Equipment, Edible Vegetable Oils, Chemicals, Fertilisers.

SUMMARY

1. External Trade

External Trade or foreign trade refers to buying and selling of goods and services between the nationals of different countries living across political frontiers, or trade between agencies of the governments of different countries. It consists of export, import and entrepot trade.

2. Nature and Importance of External Trade

The necessity of external trade rises mainly because no country is capable of producing everything equally efficiently for the consumption of its people and the development of its economy. This is due to unequal distribution of resources and skills among different countries of the world. External trade enables better use of available resources in every country, and thus improves the standard of living and well being of the people. Thus, every country can derive the benefits of geographical specialisation through external trade.

Mutual dependence of different countries for supply of their requirements is the basis of external trade Relative differences in the cost advantage of production ultimately provides the explanation of external trade. This is known as the theory of 'comparative costs'.

3. Price Quotations and Terms of Shipment

In foreign trade, *terms of shipment* are very important for concluding a contract to buy or sell goods. These terms reflect two aspects of the contract: (a) Price quotation, and (b) shipment cost and manner of shipment.

The most commonly used terms with regard to sale price are: Free on Board or F O B. (Port of Shipment); Cost & Freight or C&F (Port of Destination), Cost, Insurance & Freight or CIF (Port of Destination).

4. Terms of Payment and Export Finance

While the terms of shipment determine the responsibility of the exporter to send goods to the importer, terms of payment determine the manner of payment for goods by the importer. Generally goods are shipped first and the exporter is paid thereafter In this situation, the exporter protects himself by so arranging the shipment that the importer cannot take possession of the goods from the carrier before he has paid for the same.

There are five terms or *methods of payment* — Advance Payment; Open Account; Documentary Bills; Documentary letter of credit, and Direct remittance

5. Bills of Exchange

Banks in India provide financial assistance to the exporters at the pre-shipment stage at concession rates to purchase raw materials and processing them for export on the basis of letter of credit and export order. Advances at the post-shipment stage is given to the exporters against bills of exchange or shipping documents drawn under the letter of credit

6. Assistance by Exim Bank of India

The major function of the *Exim Bank* of India is to coordinate the working of institutions financing exports and imports. It provides export credit for medium-term and long-term where the sale is on deferred credit basis; finances export of consultancy and related services; assists setting of joint

ventures abroad, and promotes export-oriented industries in India. It also undertakes export market studies and provides merchant banking services

7. Importance of Documents

Export trade cannot take place without certain documents These are — Commercial Invoice, Bill of Lading/Airway Bill; Insurance Policy, and Bill of Exchange

Except for certain products and some destinations, there is no restriction over exports from India But a large number of products are subject to compulsory quality or pre-shipment inspection Permission from the Customs authorities is essential in all cases

8. Registration with RBI & JCCI&E

A company can enter export-import business after it is registered with the Reserve Bank of India, and the Joint Chief Controller of Imports and Exports (JCCI&E). The company must also obtain the Importer Exporter Code Number (IEC) alloted by the JCCI&E.

9. Registration with Export Promotion Council

Exporting companies have to get registered with the concerned Export Promotion Council or Commodity Board and obtain Registration-cum-membership Certificate (RCMC) to be eligible for various types of incentives given by the Government of India like Cash Compensatory Support, Import Replenishment Licence (or REP licence), etc

10. Processing of Export Order

The export procedure includes the following steps.

- (i) Obtaining the export order,
- (ii) Production and inspection of goods (Stage I);
- (iii) Movement of goods to port town (Stage II);
- (iv) Processing of shipping bill (Stage III);
- (v) Port formality and customs examination (Stage IV);
- (vi) Mate's receipt and bill of lading (Stage V),
- (vii) Submission of documents to bank (Stage VI).

11. Import Control and Policy

Control over imports into India is exercised through Import Policy announced by the Government of India. It has two parts— Import Policy for Actual Users, and Import Policy for Registered Exporters The import procedure consists of six stages as follows.

Stage I — Location of importer;
Stage II — Conclusion of contract,
Stage III — Obtaining import licence;
Stage IV — Opening letter of credit,
Stage V — Negotiation of documents, and
Stage VI — Customs clearance

QUESTIONS

I. OBJECTIVE-TYPE QUESTIONS

Which of the following statements is right and which are wrong?

1 Countries engaging in external trade are mutually benefitted because all countries depend on one another
2 "Documentary Bills" method of payment for export does not require the involvement of any bank
3. The Exim Bank of India grants pre-shipment credit beyond six months
4. A bill of lading is similar to a bill of exchange
5 To enter export-import business a company must get registered either with the Reserve Bank or Joint Chief Controller of Imports and Exports.

Fill in the blanks

(1) C.I.F stands for ____________________

(2) F.O B. means ____________________

(3) A letter of credit contains a promise by the ____________bank on behalf of the ____________________.

(4) Through external trade every country can derive the benefit of ____________________ specialisation

(5) Shipping documents are sent to the ________________ through the ______________ banks

(6) The commercial invoice serves both as a ____________________ and as a ______________.

II. SHORT-ANSWER TYPE QUESTIONS

1. Enumerate the shipping documents used in export trade.
2. Give one example each of visible export and invisible import of India.
3 Name the parties to a letter of credit.
4. What is a bill of lading?
5. Briefly outline the nature of import policy for actual users and registered exporters
6. Write a brief note on the export financing by banks
7. Why is it necessary for an exporting company to get registered with the concerned Export Promotion Council?
8. What are the benefits derived by a country from external trade?

III ESSAY-TYPE QUESTIONS

1. Explain fully the basis of external trade with reference to the theory of Comparative Cost Advantage.
2. Describe briefly the following methods of payment in export-import operation
   (i) Documentary Bill;
   (ii) Documentary letter of credit.
3. Outline the procedure involved in export trade at different stages
4. Why is export documentation necessary? Mention the more important shipping documents used in export trade.
5. Describe the procedure of importing goods into India. State the nature of import documents in that connection.

Financial Institutions in India

Name of the Institution	*Date of Formation*	*Objects*	*Capital*	*Functions*
Industrial Development Bank of India (IDBI)	1st July, 1964	1 To coordinate and supervise the activities of other financial institutions 2 To supplement the resources of other financial institutions 3 To provide finance to key industries 4 To diversify industrial growth according to national priorities.	Authorised capital Rs. 1000 crores	1 Provides direct financial assistance to industries 2. Subscribes to shares, bonds and debentures issued by industrial concerns It also underwrites such issues 3 Accepts and discounts bills, pro-notes, hundis etc of industrial concerns. 4 Guarantees loans raised by industrial concerns from banks or other financial institutions 5 Provides refinancing facilities to scheduled banks and other financial institutions

Name of the Institution	*Date of Formation*	*Objects*	*Capital*	*Functions*
Industrial Finance Corporation of India (IFCI)	1st July, 1948	1 To provide financial assistance to industrial concerns for a period not exceeding 25 years	Authorised capital Rs 100 crores.	1 Subscribes directly to shares of industrial concerns.
		2 To guarantee loans raised by industrial concerns in the open market		2. Grants loans or advances to industrial concerns subscribes to debentures of industrial concerns repayable within a period of 25 years.
		3. To underwrite the issues of shares, bonds and debentures of industrial concerns		3. Guarantees loans raised by industrial concerns from the capital market, scheduled or cooperative banks, which are repayable within a period of 25 years
				4 Guarantees (with the prior approval of the Central Government) loans raised by industrial concerns from financial institutions outside India
				5 Guarantees purchase of capital goods from foreign countries.

Name of the Institution	*Date of Formation*	*Objects*	*Capital*	*Functions*
Industrial Credit and Investment Corporation of India (ICICI)	5 January, 1955	1 To assist in the promotion, expansion and modernisation of industrial concerns in the private sector. 2. To encourage and promote participation of private capital both external and internal in such enterprises. 3 To encourage expansion of the investment market in India	Authorised capital Rs 150 crores	1 Grants medium and long term loans in rupees and foreign currencies 2 Subscribes to new issues of shares and debentures 3. Underwrites public issues of shares and debentures 4 Guarantees loans raised from private sources including deferred payments 5 Arranges technical and managerial assistance to industrial enterprises.

Name of the Institution	*Date of Formation*	*Objects*	*Capital*	*Functions*
Industrial Reconstruction Bank of India (IRBI)	19 March 1985	1 To rehabilitate sick industrial units 2 To provide assistance in the form of soft term loans and guarantees 3. To provide technical, managerial and marketing assistance.	Authorised capital Rs. 100 crores	1. Grants loans and advances to industrial concerns 2 Guarantees loans/ deferred payments of industrial concerns 3. Provides infrastructural facilities, raw materials, consultancy, managerial and banking services.

APPENDICES

STATE BANK OF INDIA

IRREVOCABLE COMMERCIAL LETTER OF CREDIT

TELEX
CABLE

This is a confirmation of the credit opened by cable under even date

MAIL TO →

Date of issue March 7, 1989	Our letter of credit No
Advising Bank	Applicant FLG 87/88
Name of the Bank	IMPORTS CORP NEW YORK, N Y 10018
Beneficiary	Amount
X Y Z TRADERS DELHI 110006 INDIA	Rs 300 000 00 FOB Expiry date for Negotiation December 7 1989

Gentlemen,

We hereby establish our irrevocable credit in your favour which is available against your drafts at ' SIGHT drawn on US for 100% invoice value of merchandise to be described in the invoice as LADIES APPAREL

And accompanied by
1 Full set of clean bills of lading to order and blank endorsed marked notify
Bills of lading must show that the goods have been shipped on board and freight paid/freight to pay
2 Airway bill consigned to State Bank of India,Marked notify APPLICANT
3 Insurance policies or certificates covering marine and war risks also riots,strikes and civil commotion for the invoice value plus %
4 Commercial invoice in DUPLICATE
5 Special Customs invoice in DUPLICATE
6 OTHER DOCUMENTS PACKING LIST IN DUPLICATE

INSURANCE TO BE EFFECTED BY BUYERS WITH AETNA UNDER POLICY NO OMO 10855 FCA

The amount of any draft drawn under this credit must be endorsed on the reverse hereof All drafts must be marked "Drawn Under State Bank of India FLUSHING letter of credit number FLG 82/84 dated DEC 7 1988
Except so far as otherwise stated, this credit is subject to the Uniform Customs and Practice for documentary credits (1974) International Chamber of Commerce Publication No 290

Shipment from	NEW DELHI INDIA	Partial shipments	ARE	permitted
To	NEW YORK USA	Trans shipment	ARE	Permitted
Last date for Shipment	FEBRUARY 15, 1989			
All foreign bank charges, if any, are for account of/beneficiaries				

Special Instruction -
Presentation of documents-within 20 days from the date of shipment of goods
AIRWAY BILL TO STATE FRIEGHT COLLECT NEW DELHI/NEW YORK'
CERTIFICATE STATING THAT SHIPMENT DOCUMENTS I E INVOICES PACKING LIST AND ORIGINAL OFFICIAL US CUSTOMS INVOICE HAVE BEEN HANDED OVER TO ROBINSONS AIR SERVICE JANPATH, NEW DELHI HOUSE AIRWAY BILL FROM SHIPPING AGENT IS ACCEPTABLE
AIRWAY BILL MUST INDICATE'TO NOTIFY AIRPORT CLEARANCE SERVICE CARGO BLDG #80 JFK INT'L AIRPORT AREA NY 11430 TEL NO 718-656-5430
We hereby agree with the drawers, endorsers and bonafide holders of drafts drawn under and in compliance with the terms of this credit that such drafts will be duly honoured upon due presentation and delivery of documents as specified above to drawee

Yours faithfully

Manager NEW DELHI

Authorised Signature

NO. ________

Exchange *for* ________ ________19

Pay this FIRST *of exchange second unpaid to the order of*

____

the sum of ________________________________

____

1

Value received ____________________________

To ____________

____

____________ ____________

NO. ________

Exchange *for* ________ ________19

Pay this SECOND *of exchange first unpaid to the order of*

____

the sum of ________________________________

____

Value received ____________________________

2

To ____________

____

____________ ____________

INVOICE

Phone
Cable
Telex

ABC FABRIC PVT. LTD.

MANUFACTURERS & EXPORTERS OF QUALITY GARMENTS

Bankers Name of the Bank

Regd Office
NEW DELHI - 110 016,
INDIA

RBI Code No

Invoice No ______________ Dated __________

Vide Mark No →
No of packages

X

Y Z

Messers

Vide Order No. ______________________

Shipped per ______________________

A/W Bill No ______________________

Documents drawn through

GRI Form No ______________________

Quantity	DESCRIPTION OF GOODS	@	Per	Amount	Total

Country of Origin INDIA

E & O.

For A B C FABRIC PVT LTD

RECOGNISED EXPORT HOUSE

PACKING & WEIGHT LIST

CASE MARKS & NO	SOLD BY	ABC FABRIC PRIVATE LTD. NEW DELHI - 110 016 INDIA	PAGE OF PAGES
DEPT			ATTACHED TO INVOICE NO
ORDER NO			DATE
MADE IN INDIA	SOLD TO		ORDER NO
CASE NOS			

CASE NUMBER	Gross wgt KG LBS	Net Wgt KG LBS	MEASUREMENTS CM FT	STYLE	COLOUR	SIZE (if applicable only)								QUANTITY IN UNITS	DO NOT COMPLETE REMARKS
TOTAL CASES	TOTAL Gross KGS LBS	TOTAL NET Wgt KGS LBS.	TOTAL CUBBAGE			TOTAL QUANTITY									

For **ABC FABRIC** Pvt Ltd

RAM (India) Pvt. Ltd.
CONNAUGHT HOUSE,
NEW DELHI-110001

CH A No 11/1961

BY SEA
SHIPPING BILL

For Goods Under Claim for Quick Drawback Scheme

ORIGINAL

Shipping Bill No ________

Date ________

Exporter's Name & Address

Name of Vessel		Master or Agent	Colour	Port at which goods to be despatched
Flight	Date			
Packages		Details of goods to be given separately for each class or description		

No of Pkgs in words & Figures	CONSIGNEE'S NAME & ADDRESS	QUANTITY & DESCRIPTION OF GOODS CODE NO	FOB VALUE Amount Rs	P	CIF Amount Rs	P	DRAWBACK Rate per Kg or %	Amount Rs	P	Country of final Destination	G R I Form No
	Gross Weight Nett Weight										R B.I Code No

1 Certified that the goods under export were not taken into use after manufacture
2 Certified that no separate claim for rebate of duty has been or will be made to the Central Excise authorities under Rule 12 or 12A of the Central Excise Rules, 1944 and that the custom and Central Excise Duty has been paid on the raw material used in the manufacture of the goods Certified that the duty free concession admissible under Rules 56-A 191 or 191(b) of the Central Excise Rule 1944 have not been availed by us.
3 Certified that the benefit of exemption of customs duty on Brass scrap in terms of Ministry of Finance (Dept. of Revenue) Notification No 74/Customs, 75/Customs dt. 15-4-80 has not been availed
4 We hereby certify that the value specification, quality and description of goods being exported as mentioned in the Shipping Bill and other relevant documents are true to the best of our knowledge and belief and also certify that the quality and specification of goods stated in the Shipping Bill and other relevant documents are in accordance with the terms of the export contract entered into with the buyers or consignee in pursuance of which the goodsbeing exported

Original Copy of GRI Form detached after comparing with other copies

G R Son's
AIR CARGO UNIT, PALAM

Let export under preventive Supervision

Assistant Collector of Customs

We hereby declare the particulars given above to be true as per documents received

For RAM (I) PVT LTD

New Delhi
Date - - 198

I/We claim the usual drawback of the above mentioned goods

Signature of the Exporters or his Authorised Agent

International Clearing and Shipping Agency

Letters of indemnity cannot be accepted in respect of the condition of package on shipment Any qualifying remarks on mate's receipt must appear in bills of lading

NOT TRANSFERABLE

SHIPPING ORDER

Cargo bookings are only made conditional upon vessel named herein or if no vessel is named a suitable vessel being available for the voyage and is subject to any direction or control by the Government

No MADRAS ______________ 198

THE COMMANDING OFFICER,

S S /M V ______________________ Expected on ______________

Dear Sir,

Please receive on board from Messrs ______________________________

______________ for the Port of ______________________________

the following goods which be accompanied by boat notes and passed shipping bill of customs

Freight Payable Madras/Destination at the rate of ______________________________
shipment on notice from Agents or (Stevedores)

Yours truly,

International Clearing & Shipping Agency

SUBJECT TO SAFE ARRIVAL AND BERTHING OF VESSEL SUBJECT TO SUITABLE STOWAGE BEING AVAILABLE

AS AGENTS

The cargo shipped under this shipping order is subject to the terms, conditions and exceptions contained in the Bills of Lading form of the Owners of the vessel, for this service

INDIA STEAMSHIP CO.,LTD.

MATES RECEIPT

C H Pass No ________________ Calcutta, 19

No ________

Received From The Commissioners for the Port of Calcutta, on board the Steamer "INDIAN ______________

____ for____________________________________

on account of____ subject to the

conditions stated in the Bills of Lading which can be obtained at the Agent's Office

____

Chief Officer

COMBINED TRANSPORT
BILL OF LADING

Shipper

KRISHNA INTERNATIONAL

B/L No
Reference No

Contract No

Consignee

Notify party

NAME OF THE PARTY

MARINE LINE

Managed by XY Group Copenhagen.

Pre Carriage by *	Place of receipt *	Shipper's memoranda not part of Bill of Lading
Ocean Vessel Voy No	Port of loading	
Port of discharge	Place of delivery *	Final Destination (Merchants description only) (Forwarding Agents)

CARRIER'S RECEIPT			PARTICULARS FURNISHED BY SHIPPER—CARRIER NOT RESPONSIBLE		
Container No	Seal No Marks and Numbers	No of Containers or pkgs	Kind of packages, description of goods	Gross weight	Measurement
			...ction Ac... F17782 Date. 1/11/87		

Freight and Charges	Revenue Tons	Rate	Per	Prepaid	Collect

Ex Rate	Prepaid at	Payable at	Place and date of issue
	Total prepaid in local currency	No of Original B(s)/L	VOLKARAT FLEMINE SHIPPING ANDSERVICES LTD.

Laden onboard and Vessel

By

By

As Agents for the Carrier

* Applicable only when used as a Combined Transport Bill of Lading